90-1852

No. _____

Supreme Court, U.S.
FILED
MAY 30 1991
OFFICE OF THE CLERK

In The

# Supreme Court of the United States

October Term, 1990

COMMONWEALTH OF VIRGINIA,
DEPARTMENT OF TAXATION,

*Petitioner,*

v.

CORNING GLASS WORKS, INC.

*Respondent.*

**Petition For A Writ Of Certiorari To The Supreme Court Of Virginia**

## PETITION FOR A WRIT OF CERTIORARI

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## QUESTIONS PRESENTED

Does due process permit a state to tax, on a fairly apportioned basis, capital gains and interest received by a nondomiciliary corporation operating within that state when:

1. the corporation paying the income also operates within the taxing state; and

2. the corporation receiving the income actively manages a large portfolio of capital stock investments as an integral part of its unitary business.

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## PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF VIRGINIA

The Attorney General of Virginia, on behalf of the Commonwealth's Department of Taxation, petitions for a writ of certiorari to review the judgment of the Supreme Court of Virginia in this case.

## OPINIONS BELOW

The opinion of the Virginia Supreme Court (App. 1-13) is reported at 241 Va. 353 and at 402 S.E.2d 35. The trial court's bench ruling and its written final order with findings of fact and conclusions of law (App. 15-21) are not reported. The ruling of the Virginia Tax Commissioner is set forth in the appendix. (App. 23-26).

## JURISDICTION

The judgment of the Virginia Supreme Court (App. 14) was entered on March 1, 1991. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257 pursuant to this Court's Rule 13.1 allowing 90 days for filing a petition for a writ of certiorari.

## CONSTITUTIONAL PROVISION INVOLVED

U.S. Const. amend. XIV, § 1 provides, in pertinent part:

> [N]or shall any State deprive any person of life, liberty, or property, without due process of law.

## STATEMENT OF THE CASE

### 1. Background: The Unitary Business Principle.

This case concerns the due process legal standards governing the allocation of authority among the states to tax a single multistate corporation's income (capital gains and interest) from the sale of intangibles (capital stock). It involves the application of the "unitary business principle" to capital gains and interest income received by a nondomiciliary corporation concedely having a substantial nexus with the taxing state. And it arises in the context of a single corporation that exemplifies the modern unitary business: a corporation that actively manages a large portfolio of capital stock investments as an integral part of its operating strategy. *See Corning's Class Act – How Jamie Houghton Reinvented the Company,* BusinessWeek 68-76 (May 13, 1991) (*"Corning's Class Act"*).

The unitary business principle is a broad, multifaceted judicial concept emanating from late nineteenth century case law sustaining the so-called "unit" method of assessing interstate railroad property for taxation.[1] The principle is an equitable doctrine that results in a sharing of jurisdiction among the states to tax income from intangibles.[2] Because of the practical impossibility of

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[1] *See State Railroad Tax Cases,* 92 U.S. 575 (1875).

[2] *See Mobil Oil Corp. v. Comm'r of Taxes,* 445 U.S. 425, 445 (1980), where this Court rejected the premise that the commercial domicile should have exclusive jurisdiction to tax income from intangibles:

> [T]here is nothing talismanic about the concepts of "business situs" or "commercial domicile" that

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determining the geographic location where income is generated, states have the right under the unitary business principle to impose fairly apportioned taxes on the entire net income of corporations operating within their borders based on formulas measuring in-state activities. This principle, consistent with established rules of state tax procedure, also allocates to the taxpayer the burden of proving that a particular item of income was not derived from the activities of its unitary business.[3]

Due process imposes two limitations on the application of this unitary business principle: (1) "a 'minimal connection' between the interstate activities and the taxing State"; and (2) "a rational relationship between the income attributed to the State and the intrastate values of the enterprise." *Trinova Corp. v. Michigan Dep't of Treasury*, ___ U.S. ___, 111 S. Ct. 818, 828 (1991) (quoting *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425, 436-37 (1980) ("*Mobil*")).

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> automatically renders those concepts applicable when taxation of income from intangibles is at issue. . . . [C]ases upholding allocation to a single situs for property tax purposes have distinguished income tax situations where the apportionment principle prevails.

[3] *See Mobil*, 445 U.S. at 439 ("In accord with this [unitary business] principle, what appellant must show . . . is that the income was earned in the course of activities unrelated to the [business conducted in the taxing state]"). *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 175 (1983) ("The general rule, applicable here, is that a taxpayer claiming immunity from a tax has the burden of establishing his exemption") (quoting *Norton Co. v. Dep't of Revenue*, 340 U.S. 534, 537 (1951)).

**2. Corning Excluded Certain Capital Gains And Interest Income From Its Income Subject To Apportionment In Virginia.**

Respondent Corning Glass Works, Inc. ("Corning") is a multistate, multinational corporation with its corporate domicile and headquarters in New York. During 1983 and 1984, Corning's unitary business activities in Virginia involved manufacturing and selling glass products. Corning also actively managed a large portfolio of investments in related subsidiary and associated companies as part of its long-standing business strategy of expanding markets for its unitary business through joint ventures and investments to foster new technologies (*e.g.*, fiber glass and fiber optics). (App. 16-17, 20).

In 1982, Corning negotiated a contract to sell three million shares of its stock in Owens Corning Fiberglass Corporation ("OCF") to OCF. Corning owned this stock as a result of its 1938 entry into the glass fibers market through a joint venture with Owens-Illinois.[4] OCF is an

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[4] At the time of the sale, Corning owned over 7 million shares of OCF stock representing an ownership interest of approximately 24%. A 1949 consent decree in a federal antitrust action ended Corning's ability directly to control OCF. (App. 2-3, 19-20).

The 1949 consent decree did not require Corning to sell its OCF stock. In 1978, Corning requested that the decree be modified to require divestiture of 90% of its OCF stock by 1986. The request was granted. (App. 3). Corning's request for modification of the decree was preceded by studies by Goldman Sachs & Co. and Lazard Freres & Co. in 1974 and 1978 evaluating how Corning could best utilize the OCF stock asset for Corning's business.

Ohio-based corporation that conducted business in part within Virginia during the years in question. OCF agreed to buy the stock on an installment basis and issued three interest-bearing notes in principal amounts totaling $97.9 million. Corning's announced purposes for the sale proceeds included repaying $130 million in corporate debt, funding expansion into new product lines such as biotechnology, and maintaining strong programs in glass and ceramics.[5]

In addition to the 1982 dispositions, Corning actively monitored its OCF stock and carefully timed dispositions for a variety of business reasons between 1949 and 1980. During the 1960s and 1970s, for example, dispositions were made to offset losses and to fund a museum of glass. Dispositions were also made to an employees' pension trust.[6]

During 1983 and 1984, Corning received capital gains and interest totaling $101,761,570 from the installment sale of its OCF stock. Corning removed this income from its income subject to apportionment in Virginia. Upon audit, the Department included the capital gains and interest in Corning's apportionable income base and

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[5] In 1982, Corning also used 2.6 million of its OCF shares to issue $100 million in debentures to generate revenue for the same basic purposes. These 1982 dispositions (3 million shares sold to OCF and 2.6 million placed in escrow for debentures) followed a 1982 Lazard Freres & Co. study evaluating Corning's many dispositional alternatives for this substantial asset.

[6] *See Corning Glass Works v. Dep't of Revenue*, 616 S.W.2d 789, 792-93 (Ky. App. 1981) ("Other capital gains were derived from . . . the contribution of shares of fiberglass company to the employees' pension trust fund").

Corning was assessed with additional taxes totaling $173,572, excluding interest. The Virginia Tax Commissioner affirmed the assessments. (App. 23-26). Corning paid the assessments and brought a refund action challenging the assessments. Corning's challenge was based on *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982) ("*ASARCO*").

In *ASARCO* a majority of this Court, with Justices Rehnquist, Blackmun and O'Connor dissenting, held that a nondomiciliary state, Idaho, in the facts presented there, could not impose an apportioned tax on dividends paid by foreign subsidiaries.[7] The foreign subsidiaries had no presence in Idaho, they were not part of ASARCO's unitary business and there was no other basis to support a finding that the dividends were part of ASARCO's unitary business. Without full argument or briefing, the Court agreed with Idaho's concession that the treatment of the dividend income would also control the treatment of capital gains and interest. *See* 458 U.S. at 330.

### 3. Trial Court Distinguished *ASARCO*; Supreme Court Of Virginia Reversed.

The trial court found (App. 16-17, 20-21) that *ASARCO* was distinguishable on two grounds: (1) OCF operated in Virginia; and (2) Corning actively managed a large portfolio of investments in subsidiary and associated companies as an integral part of Corning's unitary business.

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[7] The Court used the term "subsidiary" in a general descriptive sense. ASARCO's ownership interest in the "subsidiaries" actually ranged from 34% to 53%. *See ASARCO*, 458 U.S. at 309 n.2.

The Supreme Court of Virginia reversed. (App. 1-13). The court accepted but refused to attach any legal significance to the trial court's findings that OCF operated in Virginia and that Corning actively managed a large portfolio of stock investments as part of its unitary business. (App. 4 n.2, 12).[8] It interpreted *ASARCO* to require a unitary business relationship between Corning (the income-recipient) and OCF (the income-payor) to support apportionment of capital gains and interest. The court held that such a relationship could not exist because a 1949 consent decree in a federal antitrust action prevented Corning from controlling OCF. (App. 3, 13).

## REASONS FOR GRANTING THE PETITION

### 1. This Case Satisfies The Criteria For Certiorari: State Courts Are In Substantial Conflict And A Novel And Important Federal Question Has Been Wrongly Decided.

This Court's Rule 10.1 provides that review by certiorari is appropriate when a state court of last resort (1) "has decided a federal question in a way that conflicts

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[8] *Compare ASARCO*, 458 U.S. at 325 n.21, noting trial court's findings that ASARCO:

> "has never been required to utilize its stock as security for borrowing of working capital, acquiring stock or securities in other companies or to support any bond issues." Moreover, ASARCO was found to have "sufficient cash flow from mining to provide operating capital for all mining operations without reliance upon cash flow from . . . income from intangibles." (quoting from the trial record).

with the decision of another state court of last resort", or (2) "has decided an important question of federal law which has not been, but should be, settled by this Court". U.S. Sup. Ct. R. 10.1(b), (c). This case satisfies both of these criteria.

The ruling of the Supreme Court of Virginia directly conflicts with the decisions of sister state appellate courts. The court's decision is erroneous because it unjustifiably extends the majority holding in *ASARCO* to facts that decision expressly was not intended to cover. The Virginia Supreme Court's erroneous reading of *ASARCO* effectively removes income from intangible assets from the tax base of nondomiciliary states unless the state can prove a unitary business relationship between the income-payor (in this case, OCF) and the income-recipient (in this case, Corning).

*ASARCO* does not support this effective presumption against apportionment. The *ASARCO* majority carefully confined its holding to specific facts found by the state trial court: (1) income, primarily dividends, was paid by foreign subsidiaries operating wholly outside of Idaho; and (2) ASARCO did not actively manage or use its investments in the foreign subsidiaries for purposes relating to ASARCO's unitary business, such as obtaining loans for operating capital, supporting bond issues, or acquiring stock or securities in other companies. *See* 458 U.S. at 308-09, 325 n.21, 327 n.22, 329-30 nn.24-25.

The trial court's findings in this case were dispositively different: the trial court found that OCF did operate in Virginia and that Corning actively managed a large portfolio of capital stock investments in subsidiary and

associated companies as an integral part of Corning's own unitary business. (App. 16-17, 20-21).[9] *ASARCO* expressly was not intended to preclude fairly apportioned state taxation in these circumstances. *See ASARCO*, 458 U.S. at 325 n.21, 327 n.22, 329-30 nn.24-25 (emphasizing fact-bound nature of unitary business inquiry and relevance of facts showing operational function of stock ownership activities in taxpaying corporation's unitary business). *Accord Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 176-77 n.15, 179-80 n.19 (1983) (*"Container Corp."*). Either the presence of the income-producing asset within the taxing state[10] or the active management of a portfolio of investments as part of a

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[9] The trial court's findings in this case are overwhelmingly supported by evidence in the record showing that Corning's stock ownership activities served a variety of key operational purposes in Corning's unitary business such as issuing debt, repaying loans, diversification, cyclical protection, expansion into new product lines, funding programs in glass and ceramics, technological development and financing a major corporate reorganization at the time of the national economic downturn of the early 1980s. The success of this restructuring program, in which the OCF sale was a central element, is detailed in a recent national business journal. *See Corning's Class Act, supra.*

[10] *See Allied-Signal, Inc. v. Comm'r of Finance*, 562 N.Y.S.2d 76 (App. Div., 1st Dep't 1990), *appeal pending*, N.Y. Ct. App., Index No. 19702-88 (issuing corporation's operation within the taxing jurisdiction alone justifies imposition of apportioned tax on recipient's investment income). *Contra Int'l Paper Co. v. Director*, 11 N.J. Tax 147 (1990), *aff'd per curiam*, Slip Op. No. A-5138-89T5 (Super. Ct. App. Div. May 13, 1991).

unitary business operating within the taxing state[11] has been held sufficient to permit fairly apportioned taxation of capital gains and interest by a nondomiciliary state. As a distinguished commentator recently has observed:

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[11] *See Silent Hoist & Crane Co. v. Director*, 100 N.J. 1, 17-23 n.8, 494 A.2d 775, 783-86 n.8, *cert. denied*, 474 U.S. 995 (1985) (*ASARCO* permits apportioned taxation of portfolio investment income paid by nonunitary enterprises); *NCR Corp. v. Comptroller*, 313 Md. 118, 133-41, 544 A.2d 764, 771-75 (1988) (*ASARCO* does not prohibit apportioned taxation of income from investments in nonunitary enterprises that were "actively monitored and carefully timed so as to meet NCR's operating needs"); *Comptroller v. Armco, Inc.*, 70 Md. App. 403, 422, 521 A.2d 785, 794 (1987) ("we interpret *ASARCO* as not limiting the State's power to tax intangibles to situations where the payer and payee are conducting a unitary business"). *Accord M. Lowenstein Corp. v. South Carolina Tax Comm'n*, 298 S.C. 93, 102-03, 378 S.E.2d 272, 276-78 (Ct. App. 1989) (*ASARCO* does not require unitary business relationship between income-payor and income-recipient to support apportionment of interest on intercorporate loans made as part of lender's unitary business); *Lone Star Steel Co. v. Dolan*, 668 P.2d 916, 924-25 (Colo. 1983) (same). *Compare Williams Cos. v. Director*, 799 S.W.2d 602 (Mo. 1990), petition for cert. filed Mar. 18, 1991, Docket No. 90-1458 (apportionment of interest on intercorporate loans and gains from sale of preferred stock held justified based on facts of the particular case). *Contra, e.g., James v. Int'l Tel. & Tel. Corp.*, 654 S.W.2d 865, 868 (Mo. 1983) (*ASARCO* precluded apportionment of income from stock in nonunitary subsidiaries); *Brunner Enterprises, Inc. v. Dep't of Revenue*, 452 So. 2d 550 (Fla. 1984) (*ASARCO* prohibits apportioned taxation of gain from nondomiciliary corporation's "out-of-state" sale of stock); *American Home Products Corp. v. Limbach*, 49 Ohio St. 3d 158, 551 N.E.2d 201, 204-05, *cert. denied*, ___ U.S. ___, 111 S.Ct. 63 (1990) (*ASARCO* precluded apportionment of income from investments in nonunitary enterprises that exceeded current needs for operating capital).

> There is, in point of fact, a variety of situations in which dividends and interest ought to be recognized as apportionable by the States, under both the Due Process Clause and sound fiscal policy, in circumstances in which the payor corporations are not part of the recipient's unitary business conducted within the State. The income from temporary investments of working capital pending the need for the funds in the basic operations of the enterprise is one such category.

J. Hellerstein, *State Taxation I: Corp. Income & Franchise Taxes* ¶ 9.12[3] at S298-99 (Cum. Supp. 1989).

The Virginia Supreme Court, in focusing solely on externalities, *i.e.*, whether the payor-corporation was part of the recipient-corporation's unitary business, applied the wrong legal standard to this case. *See Container Corp.*, 463 U.S. at 178 n.17 ("there is a wide range of constitutionally acceptable variations on the unitary business theme"); P. Hartman, *Federal Limitations on State Taxation* § 9.30 at 446 (Cum. Supp. 1990) ("*ASARCO* . . . do[es] not provide any 'bright line' tests of a unitary business enterprise").[12] Review by this Court is, therefore, appropriate. *Container Corp.*, 463 U.S. at 176 ("our task must be to determine whether the state court applied the correct standards to the case; and if it did, whether its judgment 'was within the realm of permissible judgment.' ") (footnote omitted).

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[12] The Virginia Supreme Court's incomplete analysis of *ASARCO* is evident from its statement of *ASARCO's* facts. For example, the court characterizes *ASARCO* and the five subsidiaries as conducting a "vertically integrated metals operation"

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The questions presented by this case are frequently recurring and the answers divisive.[13] The Virginia

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and states that "ASARCO was the sole stockholder in each subsidiary". (App. 8). ASARCO was not the sole shareholder in any of the subsidiaries; it held ownership interests in the subsidiaries ranging from 34% to 53%. *See ASARCO*, 458 U.S. at 309 n.2. The court further describes *ASARCO* as "[r]ejecting Vermont's argument" concerning apportionment of the income in question. (App. 8). *ASARCO* concerned taxes that the State of Idaho assessed following an audit by the Multistate Tax Commission. *See ASARCO*, 458 U.S. at 312-14.

[13] *See supra* notes 10-11. In addition to the cited cases, numerous cases concerning the proper interpretation of *ASARCO* are currently pending at various stages of state administrative and judicial processes nationwide. *See, e.g., Bendix Corp. v. Director*, 10 N.J. Tax 46 (1988), *aff'd*, 237 N.J. Super. 328, 568 A.2d 59 (1989), *appeal pending* N.J. Sup. Ct. No. 31,140 (*ASARCO* does not prohibit apportioned taxation of capital gains and interest from sale of stock in nonunitary enterprise); *Mobil Oil Corp. v. Director*, 11 N.J. Tax 344 (1990), *appeal pending*, N.J. Super. Ct. App. Div. No. A-2326-90T5 (*ASARCO* bars apportioned taxation of $648 million capital gain from sale of minority stock interest in nonunitary petroleum company); *American Home Products Corp. v. Director*, 11 N.J. Tax 287 (1990), *appeal filed*, N.J. Super. Ct. App. Div., May 2, 1991 (*ASARCO* and *F.W. Woolworth Co. v. Taxation & Revenue Dep't*, 458 U.S. 354 (1982) bar apportionment of dividend and capital gains income from equity investments in nonunitary enterprises); *Jewel Cos. v. Montana Dep't of Revenue*, 1990 Mont. Tax LEXIS 81 (Mont. Bd. Tax App. 1990), *appeal pending*, Mont. 1st Jud. Dist. Ct., Lewis and Clark Co. Ct. No. BDV-89-294 (*ASARCO* does not prohibit apportioned taxation of dividends and capital gains from stock in nonunitary enterprise).

(Continued on following page)

Supreme Court's erroneous interpretation of *ASARCO* to prescribe a narrow unitary payor-recipient rule as the exclusive test of apportionability directly conflicts with numerous decisions of sister state appellate courts. *See supra* note 11; *Unitary Business Defined*, 4:8 Multistate Tax Analyst, pp. 1-3 (Oct. 1989) (discussing conflicting approaches). Accordingly, it is appropriate for this court to grant a writ of certiorari to eliminate the uncertainty and disparity in the treatment of multistate corporations that has been created by the conflicting state court interpretations of this Court's decision in *ASARCO*.

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In Virginia, two cases concerning the proper interpretation of *ASARCO* are pending at the trial court level. *W.R. Grace & Co. v. Dep't of Tax'n*, Richmond Cir. Ct. No. LM-888-4 (filed Mar. 25, 1988); *Lorillard v. Dep't of Tax'n*, Richmond Cir. Ct. No. LM-582-3 (filed Feb. 25, 1988). In addition, eleven taxpayers have filed administrative appeals involving approximately $14 million in potential refunds relying on the same erroneous interpretation of *ASARCO* that was adopted by the Virginia Supreme Court in this case.

In Pennsylvania, 41 petitions for review implicating *ASARCO* have been filed with the Pennsylvania Commonwealth Court since 1989. Three recent petitions for review well illustrate the corporate bar's increasing reliance on *ASARCO* to exclude big dollar items from apportionment. *See, e.g., The Hearst Corp. v. Commonwealth, petition for review filed* Feb. 7, 1991, Pa. Comm. Ct. No. 33 F&R CD 1991, 1991 Pa. Tax Lexis 74 ($25.9 million gain from sale of stock); *GAF Corp. v. Commonwealth, petition for review filed* Mar. 18, 1991, Pa. Comm. Ct. No. 94 F&R 1991, 1991 Pa. Tax Lexis 250 ($25.2 million in pension reversion and market investment gains); *Borden, Inc. v. Commonwealth, petition for review filed* Feb. 1, 1991, Pa. Comm. Ct. No. 10 F&R CD 1991, 1991 Pa. Tax Lexis 54 ($24.4 million in net rents, interest and gains from liquidation of "discrete business enterprises").

**2. The Virginia Supreme Court Erroneously Extended *ASARCO* To Resolve A Novel Legal Issue Expressly Excluded From That Decision.**

*ASARCO* did not involve a payor-corporation doing business in the taxing state, unlike the present case where the payor, OCF, did operate in Virginia. Rather, *ASARCO* dealt with the narrow issue

> whether the State of Idaho constitutionally may include within the taxable income of a nondomiciliary parent corporation doing some business in Idaho a portion of intangible income – such as dividend and interest payments, as well as capital gains from the sale of stock – that the parent receives *from subsidiary corporations having no other connection with the State.*

458 U.S. at 308-09 (emphasis added).[14]

The Virginia Supreme Court acknowledged but failed to attach any legal significance to the trial court's finding that OCF operated in Virginia. (App. 4 n.2). That refusal

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[14] Justice O'Connor writing for the dissent in *ASARCO* stated the issue as follows:

> ASARCO realized capital gains, dividends, and interest income from its ownership of securities issued by five foreign subsidiaries. The issue for the Court is whether that income was earned by ASARCO's unitary nonferrous metals business, and therefore was subject to Idaho's taxes, or instead was earned by a separate investment business unrelated to ASARCO's operations in Idaho, and therefore was constitutionally exempt from taxation by that State.

458 U.S. at 334.

was erroneous and unsupported by this Court's due process jurisprudence.

This Court's decisions leave no doubt that the actual physical presence of the income-producing asset within the taxing state by itself provides a sufficient nexus to support an apportioned tax. The whole purpose of the due process requirement of nexus in the corporate income tax context is to ensure that the taxing state has conferred some concrete benefit, typically the "substantial privilege of carrying on business," for which the tax is an exaction. *See Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444-45 (1940). "The simple but controlling question is whether the state has given anything for which it can ask return." *Id.* at 444. *Accord Int'l Harvester Co. v. Wisconsin Dep't of Taxation*, 322 U.S. 435, 441-42 (1944).

In this case, the income-producing asset – OCF – was present in Virginia and held a Virginia State Corporation Commission certificate of authority and good standing required to transact business. (App. 20). Virginia thus conferred valuable benefits not only on Corning, but also on OCF. These benefits and protections need not be quantified or capable of precise measurement to satisfy due process;[15] they are alone a sufficient basis to give Virginia jurisdiction to tax a portion of Corning's gain on its sale of the OCF stock asset. *See supra* note 10.

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[15] *See Goldberg v. Sweet*, 488 U.S. 252, 267 (1989) (a "wide range of benefits," including the "advantages of civilized society," satisfy the requirement that the tax fairly relate to benefits the state provides).

Corning neither alleged nor proved that Virginia's tax is an unfair exaction out of all appropriate proportion to the benefits and protections Virginia conferred on Corning *and* Corning's OCF stock asset.[16] Neither *ASARCO* nor any other decision of this Court purports to abolish state tax jurisdiction where, as here, the income-producing asset is physically present in the taxing state and the income it provides bears relation to benefits and protections conferred by that state. When "income bears relation to benefits and privileges conferred by several States[,] [t]hese are the circumstances in which apportionment is ordinarily the accepted method." *Mobil*, 445 U.S. at 446.

### 3. The Virginia Supreme Court Applied The Wrong Legal Standard: *ASARCO* Does Not Provide Any Bright-Line Test.

The overriding issue in this case is the due process legal standards that govern the authority of states to tax a single multistate corporation's income from intangibles – here Corning's capital gains and interest from the sale of

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[16] Indeed, the apportioned tax Virginia claims amounts to less than two-tenths of one percent of Corning's gain. Moreover, New York, the state of Corning's commercial domicile, recognizes the right of other states to tax capital gains and interest. Because OCF is headquartered in Ohio, the tax New York would impose on the sale of OCF stock is minimal, being based on an issuer's "allocation percentage" reflecting OCF's minimal New York presence. *See N.Y. Tax Law* §§ 208(5)-(9), 209(1), 210(1), (3)(b)(1) (McKinney 1986 & Supp. 1990); *Forbes, Inc. v. Dep't of Finance*, 66 N.Y.2d 243, 487 N.E.2d 251, 496 N.Y.S.2d 394 (1985), *cert. denied*, 475 U.S. 1109 (1986) (explaining operation of similar local tax which "allocates" investment income based on the issuing corporation's contacts reflected in an "investment allocation percentage").

its substantial OCF stock asset. Consistent with this Court's decisions, most state courts have analyzed the particular facts of the cases before them to determine whether the income producing asset or activity is part of a single corporation's unitary business. *See* cases cited *supra* notes 11, 13. Others, like the Virginia Supreme Court, have applied an incomplete analysis, quoting language from *ASARCO* out of context as doctrinal statements to deny the existence of a unitary business based solely on the lack of a unitary relationship between the income-payor corporation and the income-recipient corporation. These courts have applied a simplistic external payor-recipient rule as an exclusive bright-line test, *i.e.*, income from intangibles such as stock is not apportionable unless the income-payor has a unitary business relationship with the income-recipient.[17]

Under this Court's application of the unitary business principle, the *internal* standard that focuses on the function of the income-producing asset or activity is the correct legal standard applicable to the taxation of single,

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[17] For example, the Virginia Supreme Court reasoned that a unitary business could not exist in this case because of the 1949 antitrust consent decree terminating Corning's direct control over OCF. (App. 13). The Commonwealth's position is simply that this single fact is not controlling because it in no way negates the central role of Corning's stock ownership activities in *Corning's* unitary business.

Indeed, two of the *ASARCO* subsidiaries (General Cable and Revere Copper) were subject to an antitrust consent decree but neither the majority nor the dissent regarded this single fact as controlling. *See* 458 U.S. at 323-24; *id.* at 340-41 n.9 (O'Connor, J., dissenting).

centrally-managed corporation like Corning. Indeed, for over half a century, the decisions of this Court have uniformly sustained, under the unitary business principle, apportioned taxation of income generated by the activities of a single corporation absent proof by the taxpayer by "clear and cogent evidence" that the state's chosen method of apportionment causes unfair distortion.[18] A taxpayer cannot meet this distinct burden simply by attacking the inclusion of income in the state's preapportioned tax base:

> [T]he inclusion of income in the preapportioned tax base of a state apportionment formula does not amount to extraterritorial taxation. This

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[18] *See, e.g., Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121 (1920) ("There is . . . nothing in this record to show that the method of apportionment adopted by the State was inherently arbitrary, or that its application to this corporation produced an unreasonable result") (footnote omitted); *Norfolk & W. Ry. Co. v. North Carolina*, 297 U.S. 682, 688 (1936) ("We must bear in mind steadily that the burden is on the taxpayer to make oppression manifest by clear and cogent evidence") (citing *Underwood*, 254 U.S. at 121; *Bass, Ratliff & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271, 280, 283 (1924)); *Butler Bros. v. McColgan*, 315 U.S. 501, 507 (1942) ("One who attacks a formula of apportionment carries a distinct burden of showing by 'clear and cogent evidence' that it results in extraterritorial values being taxed") (citing *Norfolk & W. Ry. Co.*, 297 U.S. at 688); *Amerada Hess Corp. v. Director*, 490 U.S. 66, 75 (1989) ("as we have said repeatedly, in order to show unfair apportionment, a taxpayer 'must demonstrate that there is no rational relationship between the income attributed to the State and the intrastate values of the enterprise' ") (quoting *Container Corp.*, 463 U.S. at 180) (internal quotation marks omitted).

> Court has repeatedly emphasized that the function of an apportionment formula is to determine the portion of a unitary business' income that can be fairly attributed to in-state activities.

*Shell Oil Co. v. Iowa Dep't of Revenue*, 488 U.S. 19, 30-31 (1988) (citing *Exxon Corp. v. Wisconsin Dep't of Revenue*, 447 U.S. 207, 219 (1980) ("*Exxon*"); *Mobil*, 445 U.S. at 440).

Contrary to the Virginia Supreme Court's decision, *ASARCO* disavows any bright-line test of apportionability: "the application of the unitary-business principle requires in each case a careful examination both of the way in which the corporate enterprise is structured and operates, and of the relationship with the taxing State." *ASARCO*, 458 U.S. at 327 n.22.[19]

This Court's decision in *Container Corp.* confirms that there is no single bright-line test of apportionment. It is the *economic* relation, the "flow of *value*," between the various constituent activities comprising the organic business unit that is constitutionally relevant, not the deemed situs of intangible assets for property tax purposes. *See Container Corp.*, 463 U.S. at 178 n.17 (emphasis in original); *Mobil*, 445 U.S. at 445-46 (rejecting the idea that the deemed situs of intangible assets at the

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[19] *See also id.* ("[*Mobil*] sustained the taxation of investment income after applying enunciated principles carefully to the facts of the case"); *Container Corp.*, 463 U.S. at 177 n.15 ("We concluded [in *ASARCO*], *relying on factual findings made by the state courts*, that a unitary business finding was impermissible. . . . ") (emphasis in original).

commercial domicile should control in the income tax context).[20] As this case well illustrates, a single corporation, as part of its own unitary business, may actively invest in other businesses for purposes related directly to that corporation's operating strategy, such as generating operating capital, obtaining loans for operating capital, diversification, expansion, cyclical protection or developing markets for new products and technologies. *See* Dexter, *The Unitary Business Principle Revisited: Restrictions on Its Use*, 8 J. St. Tax'n 205, 213 (1990); P. Hartman, *supra*, at 437-42.

The Virginia Supreme Court's refusal to consider the operational function of Corning's stock ownership activities in Corning's unitary business was wrong. The court's decision fails to recognize the changing organizational structures that global markets, enhanced competition and changing technologies have necessitated. The fact that many strategic investments involve arm's length relationships does not render them "passive" in any sense. They are a vital part of corporate strategy and an integral part of the unitary business that Corning historically and today represents.

Corning's OCF investment illustrates this point well. The investment was undeniably an important part of Corning's corporate strategy and functioning for nearly

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[20] *See also Amerada Hess Corp. v. Director*, 490 U.S. 66, 73 (1989) ("New Jersey has a substantial connection to the oil-producing activity [occurring entirely outside the state] by virtue of the determination that this activity is conducted by a unitary business"); *Trinova*, 111 S. Ct. at 832 ("Michigan's SBT [Single Business Tax] attempts to tax a base that cannot be assigned to one location with any precision. . . . ").

half of a century. It annually provided millions of dollars in dividends, it accounted for one-sixth of Corning's net worth, and it was in a field – fiberglass – related to Corning's core glass business. Corning's ownership position in OCF was significant even if the two operated on an entirely arm's length basis. The "factors that prevent determination of the geographic location where income is generated, factors such as . . . centralization of management" (*Trinova*, 111 S. Ct. at 832), were definitely present in Corning's stock ownership and glass products activities. From its inception in the late nineteenth century, Corning's unitary business activities – manufacturing and sales and stock acquisitions and divestitures – have been actively and centrally managed by members of the Houghton family. *See Corning's Class Act, supra*, at 68, 70, 72.

This is not a case where a state seeks to combine the income of two separate corporations, one of which lacks a connection with the taxing state. It is, instead, a case where the state seeks to tax the income of a single corporation from its unitary stock ownership activities.[21] "It has long been settled that 'the entire net income of a [single] corporation, generated by interstate as well as

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[21] *See U.S. Steel Corp. v. Multistate Tax Comm'n*, 434 U.S. 452, 473 n.25 (1978) (distinguishing between the unitary business technique of calculating the entire net income of a single corporation "on the basis of all phases . . . of a single enterprise . . . even if located outside the jurisdiction," and combining the income of two or more separate corporations). *See also Container Corp.*, 463 U.S. at 168 n.5 (noting that some states employ hybrid approach).

intrastate activities, may be fairly apportioned among the States for tax purposes by formulas utilizing in-state aspects of interstate affairs.' " *Exxon*, 447 U.S. at 219 (quoting *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 460 (1959)). *Accord Mobil*, 445 U.S. at 436; *Trinova*, 111 S. Ct. at 831 ("since *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920), we have recognized the impracticability of assuming that all income can be assigned to a single source"). *See also* cases cited *supra* notes 18, 20.

**4. The Virginia Supreme Court's Overly Broad Reading Of *ASARCO* Undermines The Integrity Of State Corporate Income Tax Systems And Imposes An Undue Administrative Burden On States.**

The Virginia Supreme Court's overly broad reading of *ASARCO*, if consistently followed and applied, could seriously undermine state corporate income tax collections nationwide. Instead of a presumption of validity (*see ASARCO*, 458 U.S. at 334 (O'Connor, J., dissenting)), the Virginia Supreme Court's decision effectively shifts to the states the burden of proving unitary business relationships between income-payors and income-recipients to preserve their tax bases.

This reading of *ASARCO* imposes an enormous burden on states. States simply do not have the resources to investigate the multitudinous and diverse sources of a multistate, multinational corporation's income, much less the resources to prove unitary business relationships with multitudes of income-payors. *See* P. Hartman, *supra*, at 446-47.

The state tax revenue stakes are particularly significant because Corning exemplifies a growing trend in modern corporate business strategy. Corporations cannot be neatly compartmentalized into core (*e.g.*, manufacturing) enterprises on the one hand and investment holding companies on the other. A growing number, like Corning, actively invest in independent companies as an integral part of their operating strategy for a variety of unitary business reasons (*e.g.*, to develop new markets or learn new technologies).

The Virginia Supreme Court's overly broad reading of *ASARCO* creates a significant unknown realm of "nowhere income" not taxable by any state. There is no economic or constitutional justification for granting the commercial domicile exclusive jurisdiction to tax income from intangibles. *Mobil*, 445 U.S. at 445-46. The Virginia Supreme Court's misreading of *ASARCO* unjustifiably eliminates the taxing jurisdiction of nondomiciliary states like Virginia that have a real and substantial relationship to a unitary business that owns stock as an integral business activity.

The increasingly complex and diverse relationships that unite the modern unitary business into a global network necessitate application of the presumption that has historically guided this Court's unitary business decisions: "Presumptively all the property [and income] of the corporation . . . is held and used for purposes of its business." *Adams Express Co. v. Ohio State Auditor*, 165

U.S. 194, 227, *reh'g denied*, 166 U.S. 185 (1897).[22] There are sound reasons of constitutional law and fiscal policy supporting a general presumption of apportionability. *See* J. Hellerstein, *supra*, at S298-99.

A taxpayer cannot overcome the presumptively unitary character of its income and activities simply by pointing to an independent payor. There are other facts that may establish a unitary business relationship between the taxpayer and the income-producing asset or activity. *See Container Corp.*, 463 U.S. at 180 n.19; *ASARCO*, 458 U.S. at 325 n.21; J. Hellerstein, *supra*, at S298-99; P. Hartman, *supra*, at 437-42; Dexter, *supra*, at 213. A taxpayer, like Corning, that strategically invests in nonunitary enterprises as part of its own unitary business has no due process right to remove income generated by this unitary business *activity* from the apportionable income base of nondomiciliary states.[23]

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[22] *Accord Mobil* ("what appellant must show . . . is that the [investment] income was earned in the course of activities unrelated to the sale of petroleum products in that State." 445 U.S. at 439. "[T]he burden of proof rests upon the [taxpayer] appellant and not upon the Commissioner of Taxes. The absence of evidence in the record . . . cuts against and not in favor of appellant's cause." *Id.* at 442 n.16).

[23] The Virginia Supreme Court's overly broad reading of *ASARCO* dangerously forecloses a legislative solution to the highly controversial issue of state taxation of interstate corporate investment income. *ASARCO* should not be read to sanction such interference with the political process. *See ASARCO*, 458 U.S. at 328 n.23.

## CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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May 30, 1991

## APPENDIX A

Present: All the Justices

CORNING GLASS WORKS, INC.
v. Record No. 900872
VIRGINIA DEPARTMENT OF TAXATION

OPINION BY JUSTICE LEROY R. HASSELL
March 1, 1991

FROM THE CIRCUIT COURT OF FAIRFAX COUNTY
William G. Plummer, Judge

In this appeal, we consider whether the Fourteenth Amendment of the United States Constitution[1] prohibits the Virginia Department of Taxation from taxing capital gains and interest income that Corning Glass Works, Inc., a multistate and multinational corporation, received from a corporation in which it owned a significant stock interest.

Corning Glass, incorporated in New York, transacts business in most states and in approximately 12 foreign countries. In 1982 and 1983, the relevant tax years, Corning Glass' principal place of business was in Corning, New York. In those years, Corning Glass developed, manufactured, and marketed consumer products, consumer durable components, capital goods components, and health and science products.

In the late 1930's, Corning Glass and Owens-Illinois Glass Company formed Owens-Corning Fiberglas

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[1] The Fourteenth Amendment of the United States Constitution provides in part that no state shall "deprive any person of life, liberty, or property, without due process of law." U.S. Const. amend. XIV, § 1.

Corporation. Owens-Corning was created to develop, manufacture, and sell fiber glass products. Corning Glass appointed members to Owens-Corning's board of directors and exercised strategic control and influence over Owens-Corning.

In July 1948, the United States of America filed an amended complaint in a federal district court in Ohio, and alleged that Corning Glass, Owens-Corning, and Owens-Illinois had committed certain antitrust violations in contravention of the Sherman Act. A consent decree, in the form of a final judgment, was entered by the court on June 23, 1949.

Pursuant to the terms of the judgment, Corning Glass, its officers, directors, and employees, were prohibited from serving as officers, directors, or employees of Owens-Corning. Corning Glass was enjoined and restrained, so long as it was entitled to vote any of the shares of the capital stock of Owens-Corning, from:

> (A) Participating in, controlling, directing or influencing in any manner whatsoever any act or commercial policy of Owens-Corning except with respect to the matters as to which stock can be voted as set forth in this Article;
>
> (B) Exercising the right to vote any stock of Owens-Corning for any purpose other than (1) the election or removal of directors, subject to the provisions . . . of this Article; and (2) such necessary business acts as, under Owens-Corning's certificate of incorporation, require the vote of the stock of Owens-Illinois and Corning and are approved by the Attorney General . . . .

> (C) Exercising the right to vote the stock of Owens-Corning for the election of any individual as a director who shall not be approved by the Court . . . .
>
> (D) Exercising the right to vote the stock of Owens-Corning for the removal of any director unless the Court shall approve such proposed action.

Corning Glass, its officers, directors, agents, employees, successors, and all persons acting under, through, or for Corning Glass were required to comply with the judgment. The court retained jurisdiction over Corning Glass, Owens-Illinois, and Owens-Corning for the purpose of modification, enforcement, or termination of the order.

Corning Glass' relationship with Owens-Corning changed significantly after the entry of the judgment. Owens-Corning's directors who had been appointed by Corning Glass resigned. Corning Glass ceased having any relationship, except on a third-party basis and as a large stockholder, with Owens-Corning. Corning Glass instructed its employees that they could not have any business dealings with Owens-Corning.

In 1978, Corning Glass sought and obtained a modification of the 1949 judgment. The modified judgment required that Corning Glass dispose of its stock in Owens-Corning by 1986. Corning Glass sold 3,000,000 shares of its stock to Owens-Corning in late 1982. The proceeds were placed in the general operating funds of Corning Glass.

Corning Glass acquired, divested, and maintained stock in numerous foreign and domestic corporations.

Between 1964 and 1982, these investments accounted for approximately 28% of Corning Glass' income. In 1982, Corning Glass owned in excess of 7,000,000 shares of Owens-Corning stock, which represented a 24% ownership interest.

In 1983 and 1984, Corning Glass realized capital gains and interest income totaling $100,761,570 from the sale of some of its Owens-Corning stock.[2] Corning Glass deducted this income from its total income in computing the apportionable income reported on its 1983 and 1984 Virginia corporate income tax returns.[3] Upon audit, the Department included the capital gains and interest in Corning Glass' apportionable income and assessed Corning Glass with additional taxes for 1983 and 1984 totaling $173,571.90, plus interest of $62,120. Corning Glass filed applications for administrative correction of assessments with the Tax Commissioner. The applications were denied.

Corning Glass paid the taxes and interest in dispute and filed an amended application for relief from tax

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[2] Corning Glass operated two manufacturing plants and a sales office in Virginia. Owens-Corning also conducted business in Virginia.

[3] Virginia's allocation and apportionment taxation scheme was enacted by the General Assembly in 1981. Dividends received by nondomiciliary corporations, such as Corning Glass, are allocated to the commercial domicile and the corporation's remaining taxable income is apportioned for taxation by Virginia. *See* Code §§ 58.1-407 through 420. Title 58 of the Code was recodified in Title 58.1 in 1984. *See* 1984 Acts, c. 675. The recodification made no substantive changes relevant to this appeal.

assessment in the circuit court. The trial court considered evidence and memoranda of counsel, and concluded that the Department was constitutionally permitted to tax the capital gains and interest income that Corning Glass realized from the sale of its stock in Owens-Corning because, "[a] unitary business exists with respect to Corning and its investment in [Owens-Corning]."

On appeal, Corning Glass argues that the circuit court erred because it did not properly apply the unitary business principle to determine whether the Due Process Clause of the Fourteenth Amendment permitted the Department to tax the capital gains and interest income. Corning Glass asserts that it and Owens-Corning do not comprise a unitary business, but rather that Owens-Corning is a discrete business enterprise which has no relationship to Corning Glass' presence in Virginia. The Department, however, contends that Corning Glass' acquisition and divestiture of stock was "a regular and integral" business activity which rendered its relationship with Owens-Corning "unitary" and, therefore, taxation of the capital gains and interest income is constitutionally permissible.

The Due Process Clause of the Fourteenth Amendment prohibits a state from imposing a tax on income earned outside of its borders unless there is a "minimal connection" or "nexus" between the interstate activities and the taxing state and "a rational relationship between the income attributed to the State and the intrastate values of the enterprise." *Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. 207, 219-20 (1980) (quoting *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 436-37 (1980)).

It is undisputed that Corning Glass has a "minimal connection" with Virginia. Corning Glass conducts business in Virginia and therefore "avails itself of the 'substantial privilege of carrying on business' within the State." *Id.* at 220 (*quoting Mobil Oil Corp.*, 445 U.S. at 437). The legal principles which we must apply in ascertaining whether "a rational relationship between the income attributed to the State and the intrastate values of the enterprise" exists were discussed and applied by the Supreme Court in *F. W. Woolworth Co. v. Taxation and Revenue Dept.*, 458 U.S. 354 (1982); *ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982); *Exxon Corp.*; and *Mobil Oil Corp.*

The Court, in *Exxon Corp.*, discussed the fundamental precept which must be met when a state seeks to tax income generated beyond its borders:

> The 'linchpin of apportionability' for state income taxation of an interstate enterprise is the 'unitary-business principle.' . . . If a company is a unitary business, then a State may apply an apportionment formula to the taxpayer's total income in order to obtain a 'rough approximation' of the corporate income that is 'reasonably related to the activities conducted within the taxing State . . . .' The court looks to the 'underlying economic realities of a unitary business,' and the income must derive from 'unrelated business activity' which constitutes a 'discrete business enterprise.'

447 U.S. at 223-24 (citations omitted).

In *Mobil Oil Corp.*, the Court considered whether the Due Process Clause permitted a state to tax dividend

income that a nondomiciliary corporation received from subsidiaries and affiliates doing business abroad.

Mobil conducted an international integrated petroleum business which included petroleum exploration, production, refining, transportation, distribution, sales, and chemical and mining enterprises. The State of Vermont imposed a tax, using an apportionment formula, upon Mobil's dividend income that it received from subsidiaries and affiliates which did not conduct business in Vermont. Mobil argued that taxation of the dividend income by Vermont violated, among other things, the Due Process Clause of the Fourteenth Amendment. The Court, summarizing established principles of corporate taxation, stated:

> For a State to tax income generated in interstate commerce, the Due Process Clause of the Fourteenth amendment imposes two requirements: a 'minimal connection' between the interstate activities and the taxing State, and a rational relationship between the income attributed to the State and the intrastate values of the enterprise . . . . The requisite 'nexus' is supplied if the corporation avails itself of the 'substantial privilege of carrying on business' within the State; and '[t]he fact that a tax is contingent upon events brought to pass without a state does not destroy the nexus between such a tax and transactions within a state for which the tax is an exaction.'

445 U.S. at 436-37 (citations omitted).

Even though the Court concluded that a unitary business relationship existed among Mobil and its subsidiaries, which vested with Vermont the constitutional power to tax the dividend income, the Court cautioned:

> We do not mean to suggest that all dividend income received by corporations operating in interstate commerce is necessarily taxable in each State where that corporation does business. Where the business activities of the dividend payor have nothing to do with the activities of the recipient in the taxing State, due process considerations might well preclude apportionability, because there would be no underlying unitary business.

*Id.* at 441-42.

In *ASARCO Inc. v. Idaho State Tax Comm'n, supra,* the Court considered whether Idaho could tax dividend, interest, and capital gains income that a nondomiciliary corporation received from subsidiary corporations which had no other connection with Idaho.

ASARCO, with its five subsidiaries, conducted a vertically integrated metals operation. ASARCO was the sole stockholder in each subsidiary and received dividend income from each subsidiary. ASARCO and its subsidiaries had interlocking officers and directors which enabled ASARCO to control the major management decisions of each subsidiary. The sales between the companies were numerous making it "apparent . . . that the companies supplied markets to each other." ASARCO and its subsidiaries shared certain services. 458 U.S. at 313.

The Court, applying the unitary business principle, analyzed the business relationships which existed between ASARCO and each of its five subsidiaries and held that a unitary business relationship between ASARCO and its subsidiaries did not exist. Rejecting Vermont's argument that the dividend, interest, and capital gains income should be considered a part of a unitary

business because the income was "acquired, managed, or disposed of for purposes relating or contributing to the taxpayer's business," the Court stated:

> This definition of unitary business would destroy the concept. The business of a corporation requires that it earn money to continue operations and to provide a return on its invested capital. Consequently *all* of its operations, including any investment made, in some sense can be said to be 'for purposes related to or contributing to the [corporation's] business.' When pressed to its logical limit, this conception of the 'unitary business' limitation becomes no limitation at all. When less ambitious interpretations are employed, the result is simply arbitrary.

*Id.* at 326 (emphasis in original).

The Court further discussed the unitary business principle in *F. W. Woolworth Co.*, which was argued with and decided the same day as *ASARCO*. Woolworth owned four foreign subsidiaries. Three were wholly owned, and Woolworth owned approximately 52.7% of the stock in the fourth subsidiary. The New Mexico Taxation and Revenue Department determined that Woolworth should have included the dividends that it received from its subsidiaries in its apportionable income. The Court observed:

> Income, from whatever source, always is a 'business advantage' to a corporation. Our cases demand more. In particular, they specify that the proper inquiry looks to 'the underlying unity or diversity of business enterprise,' . . . not to whether the nondomiciliary parent derives some economic benefit – as it virtually always

> will – from its ownership of stock in another corporation . . . .
>
> In *Mobil* we emphasized, as relevant to the right of a State to tax dividends from foreign subsidiaries, the question whether 'contributions to income [of the subsidiaries] result[ed] from functional integration, centralization of management, and economies of scale.' . . . If such 'factors of profitability' arising 'from the operation of the business as a whole' exist and evidence the operation of a unitary business, a State can gain a justification for its tax consideration of value that has no other connection with that State.

458 U.S. at 363-64 (citations omitted).

The Court applied those principles to the relationship which existed among Woolworth and its foreign subsidiaries and held that a unitary business relationship did not exist. Among the factors that the Court considered in concluding that a unitary business relationship did not exist were: (i) no phase of the subsidiary's business was integrated with the parent's business; (ii) each subsidiary had a complete accounting department and financial staff; (iii) the parent did not engage in any centralized purchasing, manufacturing, or warehousing of merchandise; (iv) the parent had no central personnel training school for its foreign subsidiaries; (v) the subsidiary was responsible for obtaining its own financing from sources other than the parent; (vi) the parent's operations were not functionally integrated with its subsidiaries; (vii) each subsidiary operated as a distinct business enterprise at the level of permanent management and; (viii) with one

possible exception, none of the subsidiaries' officers during the year in question was a current or former employee of the parent.[4] *Id.* at 364-66.

Application of the principles articulated by the Supreme Court in *Exxon Corp., Mobil Oil Corp., ASARCO,* and *F. W. Woolworth* persuades us to hold that the Department may not, consistent with due process, tax the capital gains and interest income that Corning Glass received from the sale of Owens-Corning stock. The "factors of profitability" arising "from the operation of the business as a whole" do not evidence the operation of a unitary business between Corning Glass and Owens-Corning. In fact, just the contrary exists.

Corning Glass and its employees were prohibited by court order from influencing the business operations of Owens-Corning. Owens-Corning's officers did not consult with Corning Glass regarding business decisions. Corning Glass did not provide financial assistance to Owens-Corning. Corning Glass and Owens-Corning did not assist each other with personnel needs, or share technological or proprietary information. Corning Glass and Owens-Corning did not engage in any bulk purchase of

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[4] The Court held that a unitary relationship did not exist even though there were managerial links, irregular in-person and frequent mail, telephone, and teletype communications between the upper echelons of management of the parent and the subsidiaries. "Decisions about major financial decisions, such as the amount of dividends to be paid by the subsidiaries and the creation of substantial debt, had to be approved by the parent. . . . Woolworth's published financial statements, such as its annual reports, were prepared on a consolidated basis." *F. W. Woolworth Co.,* 458 U.S. at 368-69.

supplies. Corning Glass did not purchase equipment for Owens-Corning. Corning Glass and Owens-Corning did not use each other's distribution systems to market products. The two companies did not share any professional services. Corning Glass received information about Owens-Corning through public disseminations that Owens-Corning distributed to all its shareholders. With the exception of dividend payments Owens-Corning made to Corning Glass, there was no flow of funds between the two companies.

It is true that Corning Glass had significant stock holdings in Owens-Corning and other corporations. However, this fact alone is not sufficient to support a legal conclusion that a unitary business relationship existed between Corning Glass and Owens-Corning. As the Supreme Court has stated:

> [T]he [unitary business] principles . . . require that the out-of-state activities of the purported 'unitary business' be related in some concrete way to the in-state activities. The functional meaning of this requirement is that there be some sharing or exchange of value not capable of precise identification or measurement – beyond the mere flow of funds arising out of a passive investment or a distinct business operation – which renders formula apportionment a reasonable method of taxation.

*Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 166 (1983). Additionally, "[o]ne must look principally at the underlying activity, not at the form of investment, to determine the propriety of apportionability." *Mobil Oil Corp.*, 445 U.S. at 440.

An examination of the underlying activity between Corning Glass and Owens-Corning makes it exceedingly clear that a unitary business relationship did not exist and legally could not have existed in view of the judgment order entered in the antitrust case. Accordingly, we will reverse the judgment of the trial court and remand this proceeding for the entry of an order consistent with this decision.[5]

*Reversed and remanded.*

---

[5] In view of our decision, we need not consider the appellant's other assignments of error.

## APPENDIX B

*VIRGINIA:*

*In the Supreme Court of Virginia held at the Supreme Court Building in the City of Richmond on* Friday *the* 1st *day of* March, 1991.

Corning Glass Works, Inc., Appellant,

against Record No. 900872
Circuit Court No. L-81940

Virginia Department of Taxation, Appellee.

Upon an appeal from a judgment rendered by the Circuit Court of Fairfax County on the 23rd day of February, 1990.

For reasons stated in writing and filed with the record, the Court is of opinion that the judgment appealed from is erroneous. Accordingly, the judgment is reversed and annulled, and the case is remanded to the said circuit court for the entry of an order consistent with the written opinion of this Court.

This order shall be certified to the said circuit court.

A Copy,
Teste:

/s/ David B. Beach
Clerk

## APPENDIX C

VIRGINIA

IN THE CIRCUIT COURT OF FAIRFAX COUNTY

CORNING GLASS WORKS, INC.,

Plaintiff,

versus, AT LAW NO. 81940

DEPARTMENT OF TAXATION,

Defendant.

Fairfax, Virginia

Friday, June 23, 1989

The above-entitled action came on to be heard before the Honorable William J. Plummer, a Judge for the Circuit Court of Fairfax County, in Courtroom 5H, The Jennings Judicial Center, Fairfax, Virginia 22030, beginning at 11:00 o'clock a.m.

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[p. 13] THE COURT: In going through these cases from the Supreme Court and otherwise, but especially the Supreme Court, there even appears to be some vacillation by some of the members in their voting on these various cases. The Asarco case has one way. I think Chief Justice Berger was in the majority, and I think he was in the minority on another case.

It's hard to tell what the present Supreme Court of the United States would do with this case. You've got

such a change of personnel. There is no question that Asarco and its follow on cases have been criticized in the literature. Whether or not that criticism would be accepted by the present Supreme Court, I have no idea. I'm just a trial judge.

There are some what I think are major differences [p. 14] in the factual situation in this relationship. I don't know what weight the judges in Asarco gave to the fact that they recited – and that was that the parent receives from subsidiary corporations having no other connection with this state. The subsidiary in Asarco was not in the taxing state.

In this case there is the fact that OCF did business in the state of Virginia, is authorized by the state of Virginia throughout the time period, and it still does. And therefore, part of its income came from activities in the state of Virginia. Now what weight the Supreme Court put on that factor, I don't know. I can't tell from reading it. But they did recite that as a fact in the Asarco case.

This applicant, Corning Glass Works, has four basic ways that it has stated that it does business, four basic products, in effect. They have a fifth one and it's clear, from their accounting and the various exhibits that were in evidence, that the fifth way is owning stock.

It does business – rather than doing it directly, it has historically throughout the years done business through subsidiaries with the obviously dividend income from those, but from time to time the sale of stock or transfer, [p. 15] exchange of stock, or the other methods it did. I find that that's part of their active day to day businesses

in the purchase of stock and then on occasions the sale of the stock.

In this particular subsidiary they disposed of their stock from time to time as it was to their business advantage, either for tax purposes or liquidity purposes so that they could pursue other business purposes.

I find in favor of the respondent on this, and inasmuch as the taxes have already been paid, of course, there's no need for a suspending bond. They've already paid their taxes. They can just go ahead with their appeal without any further order from me. Unless somebody disagrees, I don't see that there's a need for a suspending bond of any kind. Will you prepare the order please, ma'am?

MS. ROSE: Yes.

THE COURT: The Court agrees with the analysis of the Department of Taxation and asks counsel for the tax department to prepare a draft of order that has appropriate findings of fact and conclusions of law and submit it to counsel for review.

(Whereupon, at 11:20 o'clock p.m., the hearing in the above-captioned matter was concluded.)

## APPENDIX D

VIRGINIA:

IN THE CIRCUIT COURT FOR THE
COUNTY OF FAIRFAX

CORNING GLASS WORKS,

Applicant,

v. LAW NO. 81940

DEPARTMENT OF TAXATION,

Respondent.

### FINAL ORDER

This case came for trial before the Court on June 7, 1989 pursuant to § 58.1-1825 of the Code of Virginia. Based on the evidence presented and written memoranda, and for the reasons stated in the Court's June 23, 1989 ruling from the bench, it is ADJUDGED, ORDERED and DECREED as follows:

1. The Court finds the facts and law to be as set forth in Exhibit A attached to this Final Order.

2. The Court denies Applicant Corning Glass Work's Amended Application for Relief From Tax Assessment and affirms Respondent Department of Taxation's assessments of additional tax and interest totaling $188,206.88 and $47,485.46 for 1983 and 1984, respectively.

3. A copy of this Final Order shall be certified by the Clerk of this Court to the Tax Commissioner, 2220 West Broad Street, Richmond, Virginia 23220 and to all counsel of record.

Entered this 23rd day of February, 1990.

/s/ William G. Plummer
William G. Plummer, Judge

Submitted by Clerk to me on February 22, 1990.

Exhibit A

FINDINGS OF FACT
AND CONCLUSIONS OF LAW

Based on the evidence presented, the Court finds the facts and law in this case to be as set forth below.

## FINDINGS OF FACT

1. Corning Glass Works ("Corning"), a New York corporation, is a multistate, multinational corporation which does business in Virginia through manufacturing and sales facilities located therein.

2. The Department of Taxation ("the Department") audited Corning for the tax years 1983 and 1984, and assessed additional tax and interest of $188,206.88 and $47,485.46, respectively. The additional assessment was based on taxation of capital gain and interest income received by Corning upon the 1982 sale of approximately three million shares of its stock in the Owens-Corning Fiberglas Corporation ("OCF").

3. Corning and Owens-Illinois Glass Company created OCF in the late 1930's to engage in the manufacture and sale of glass fibers and glass fiber products. Corning

originally owned approximately 50 percent of the outstanding common stock of OCF in 1939. At the time of the sale in 1982, Corning owned approximately 24 percent of the outstanding common stock of OCF.

4. OCF, a corporation existing under the laws of Delaware, currently holds and has held a certificate of authority to transact business in Virginia since July 16, 1968. OCF did business in Virginia during the period in question.

5. Corning has four basic ways that it does business, in effect, four basic products. Corning has a fifth way of doing business which, as is evident from its accounting and the various exhibits introduced at trial, is owning stock. Historically throughout the years, Corning has done business, rather than doing it directly, through subsidiaries which generate income through dividends, and, from time to time, through the sale, transfer, or exchange of stock, or through other methods. Part of Corning's active day-to-day business is the purchase of stock and on occasions the sale of stock.

6. Corning has a centralized management and corporate strategy. The income resulting from the sale which give rise to the capital gain and interest income at issue was placed in Corning's general corporate fund and, with other corporate funds, was used to help Corning meet its cash needs for expansion and general operations.

7. Corning sold its stock in OCF from time to time as it was to its business advantage, either for tax or liquidity purposes so that they could pursue other business purposes.

## CONCLUSIONS OF LAW

1. Corning's capital gains and interest from notes on the installment sale of OCF stock owned by Corning, a nondomiciliary corporation doing business in Virginia, are included in its Virginia taxable income which is subject to apportionment pursuant to § 58.1-408 of the Code of Virginia.

2. A unitary business exists with respect to Corning and its investment in OCF and the capital gains and interest income from the sale of that investment at issue in this case.

3. This Court concludes that *ASARCO, Inc. v. Idaho,* 458 U.S. 307 (1982) does not control the result in the case at issue and is distinguishable on its facts because throughout the time period in question OCF did business in Virginia, while in *ASARCO, Inc.* the subsidiary corporation was not in the taxing state. The Court does not know what weight the Supreme Court gave to the facts it recited in *ASARCO, Inc.* The Court also does not know what the current Supreme Court would do with this case in light of the change in that Court's membership.

4. Corning did not meet its distinct burden of proof which required a showing by clear and cogent evidence that the assessment was erroneous.

5. Corning, a nondomiciliary corporation doing business in Virginia, is subject to tax in Virginia pursuant to §§ 58.1-400, 58.1-402, 58.1-406. 58.1-408 of the Code of Virginia.

6. The Court agrees with the analysis of the Department.

We ask for this:

/s/ Julia K. Hatcher
Peter R. Messitt
Julia K. Hatcher
Assistant Attorneys General

Barbara M. Rose
Senior Assistant Attorney General

Walter A. McFarlane
Deputy Attorney General

Mary Sue Terry
Attorney General
Office of the Attorney General
101 North Eighth Street
Richmond, Virginia 23219
Counsel for the Department of Taxation

Seen and Objected to:

/s/ John M. Wood
John M. Wood, Esq.
Daniel K. Steen, Esq.
Reed, Smith, Shaw & McClay
1200 18th Street, Northwest
Washington, D.C.
Counsel for Corning Glass Works

A COPY TESTE:

WARREN E. BARRY, CLERK

By: /s/ Mary L. Gallihugh
Deputy Clerk

Original retained in the office of the Clerk of the Circuit Court of Fairfax County, Virginia

## APPENDIX E

[SEAL]

*COMMONWEALTH of VIRGINIA*

*Department of Taxation*
*Richmond, Virginia 23282*

October 14, 1987

Mr. Robert A. Carothers
Tax Director
Corning Glass Works
Corning, NY 14831

Taxpayer: Corning Glass Works
FEIN: 16-0393470 Va. Acct: 0010417351

| Assessments: | Year | Bill No. | Date | Tax Assessed |
|---|---|---|---|---|
| | 1983 | 63921 | 1/17/86 | $135,963.00 |
| | 1984 | 60548 | 3/17/87 | 37,608.90 |

Re: § 58.1-1821 Application; Corporation Income Tax
§ 58.1-408 Apportionment of Income

Dear Mr. Carothers:

This is in response to your letter of March 27, 1987, protesting an assessment of tax for 1984, and a letter of January 28, 1986, protesting an assessment of tax for 1983. Since the issues are identical, both assessments will be addressed in this letter.

### Facts

In its returns for the years in question the taxpayer included certain capital gains and interest in allocable

income. The auditor included this income in apportionable income.

The capital gain and interest in question were derived from the installment sale of stock in a subsidiary. Pursuant to a consent decree entered in antitrust litigation, the taxpayer had been prohibited from exercising any control or direction in management, commercial policy or other dealings with the subsidiary, and ultimately was required to divest a substantial amount of stock of the subsidiary. The capital gain and interest income arose from the required divestiture.

The taxpayer also protests the assessment for 1983 on the grounds that it did not allow credit for an overpayment of tax for 1981.

## Discussion

*Income From Virginia Sources*

The taxpayer claims that the assessments are erroneous because the sale of stock is not "income from Virginia sources" as that term is defined in § 58.1-302 of the Code of Virginia ("Income and deductions from Virginia sources").

Section 58.1-302 contains definitions only. One must look to other sections of the Code of Virginia to see how the defined terms are used. In this case the operative section is § 58.1-400, which reads as follows:

> A tax at the rate of six percent is hereby annually imposed on the Virginia taxable income for each taxable year of every corporation organized under the laws of the Commonwealth and

> every foreign corporation having income from Virginia sources.

The taxpayer is a foreign corporation. Even if it is assumed that the capital gain and interest in question are not income from Virginia sources, the taxpayer has other income which clearly is income from Virginia sources. Therefore, the taxpayer is subject to an annual six percent tax on its "Virginia taxable income," not its "income from Virginia sources." The adjustments by the auditor follow the statutory procedure for computing the Virginia taxable income of a multistate corporation set forth in §§ 58.1-402 and 58.1-406.

*Federal Limitations on State Taxation*

The taxpayer claims that the inclusion of this capital gain and interest in apportionable income results in taxing extraterritorial income having no relationship with the taxpayer's presence in Virginia in violation of the U.S. Constitution.

The taxpayer's argument relies on a number of court cases which have stated that income must be derived from a unitary business in order to be apportioned. The taxpayer claims that the income in question is nonbusiness income, or, in other words, income which is not derived from a unitary business. Therefore, the nonbusiness income can not be included in apportionable income.

First of all, it is important to note that Virginia is not seeking to include any income earned by the subsidiary in the Taxpayer's apportionable income, either through consolidation or by apportioning dividend income. The income in question is received directly by the taxpayer as

a consequence of a transaction between the taxpayer and an unrelated party.

The Virginia taxable income of the taxpayer is reduced by the salary, travel and other expenses of the taxpayer's employees involved in the transaction. The taxpayer had to seek a purchaser, negotiate the terms of the sale and consummate it. The decision to accept the purchaser's notes in payment, which generated the interest in question, required consideration of the purchaser's credit worthiness, the taxpayer's capital structure and cash management, as well as the terms of the note and sales contract. All of this activity had to be performed by the taxpayer's board of directors or by its employees.

No court has held that Virginia's allocation and apportionment laws result in unconstitutional taxation of extraterritorial values and the department does not believe that any such holding is likely. In particular, the department does not believe that Virginia is prohibited from apportioning income arising from this transaction.

Determination

Accordingly, the assessment of additional tax for 1983 and 1984 is correct and is now due and payable. You will shortly receive an updated bill reflecting interest accrued to date and the application of the 1981 refund to the balance due for 1983. The bill should be paid within thirty days to avoid the accrual of additional interest.

Sincerely,

/s/ W. H. Forst
W. H. Forst
Tax Commissioner

FILED
JUL 3 1991
OFFICE OF THE CLERK

(2)

No. 90-1852

In The

# Supreme Court of the United States

October Term, 1991

COMMONWEALTH OF VIRGINIA,
DEPARTMENT OF TAXATION,

*Petitioner,*

v.

CORNING, INC.,

*Respondent.*

**Petition For Writ Of Certiorari To The Supreme Court Of Virginia**

## BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

*JOHN M. WOOD
DANIEL K. STEEN
MICHAEL D. SMITH
REED SMITH SHAW & MCCLAY
1200 18th Street, N.W.
Washington, D.C. 20036
(202) 457-6100
*Counsel of Record
for Respondent

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

## QUESTION PRESENTED

Whether a state must apply this Court's precedent in deciding whether a unitary business exists for purposes of taxing capital gains and interest income received by a nondomiciliary corporation from the sale of a passive, long-term investment in a corporation which it did not operate, and was barred by court decree from operating?

## LIST OF PARTIES

The Petitioner in this case is the Commonwealth of Virginia, Department of Taxation, an agency of the Commonwealth of Virginia. The Respondent is Corning, Inc. ("Corning"), formerly Corning Glass Works, Inc.

Pursuant to Supreme Court Rule 29.1, the Court is advised that Corning has no parent corporation. Corning has interests in wholly-owned subsidiaries and the following subsidiaries which are not wholly-owned: Corning France, S.A. (France), Corning S.p.A. (Italy), QVF Glastechnik GmbH (Germany), Corning Asahi Video Products Company (New York), Hazelton France (France), PCO, Inc. (Delaware), Siecor Corporation (Delaware), MerriCor, Inc. (Washington), Compania de Fibre Optica Telcor, S.A. (Spain), Dow Corning Corporation (Michigan), Pittsburgh Corning Corporation (Pennsylvania), Pittsburgh Corning Europe N.V. (Belgium), Pittsburgh Corning (U.K.) Ltd. (United Kingdom), Samsung-Corning Corporation, Ltd. (Korea), Siecor GmbH (Germany), N-Cor, Ltd. (Japan), Glass Technologies Ptc. Ltd. (Singapore), Sicover, S.A. (France), Optical Fibres (United Kingdom), Siecor GmbH & Co. KG (Germany), Shanghai Corning Engineering Corporation, Ltd. (Peoples Republic of China), Optical Waveguides Australia Pty. Ltd. (Australia), Steuben Partners, L.P. (Connecticut), Fairfield Venture Partners II, L.P. (Connecticut), Corporate Venture Partners (Delaware), International Hua-Mei Glass Engineering Co., Ltd. (Peoples Republic of China), Hazleton Clinical Research Institute, Inc. (Delaware), Iwaki-Corning (Malaysia) Sdn. Bhd. (Malaysia), Unilab Corporation (Colorado), CAPL S.p.A. (Italy), Eurokera S.N.C.

**LIST OF PARTIES** – Continued

(France), Moduletec SARI (France), Morgane S.A. (France), Newco Partnership (Ohio), Corsam Glasstec R&D Center (Delaware), Samcor Glass Limited (India), Daehan Specialty Chemical Co. (Korea), Watkins Glen International, Inc. (New York), Cornetech, Inc. (Delaware), TEFOSA (Spain), and Doane Associates (Michigan).

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No. 90-1852

In The

# Supreme Court of the United States

October Term, 1991

COMMONWEALTH OF VIRGINIA,
DEPARTMENT OF TAXATION,

*Petitioner,*

v.

CORNING, INC.,

*Respondent.*

**Petition For Writ Of Certiorari To The Supreme Court Of Virginia**

## BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

The Petition for a Writ of Certiorari ("Petition") filed by the Commonwealth of Virginia, Department of Taxation ("Department") seeks review of a 7-0 decision of the Supreme Court of Virginia. That decision held that this Court's ruling in *ASARCO, Inc. v. Idaho State Tax Commissioner*, 458 U.S. 307 (1982) continues to be the controlling law to be applied in determining whether, for purposes of taxation, a unitary business exists. The Court applied those principles to the unique facts of this case and correctly concluded that a unitary business did not exist and could not have existed.

## STATEMENT OF THE CASE

Corning is a New York State corporation with corporate headquarters located in Corning, New York. The Supreme Court of Virginia's opinion sets forth the facts of Corning's passive investment in Owens-Corning Fiberglas ("OCF") and demonstrates that, since 1949, Corning was legally prohibited from exercising, and did not, exercise any control over OCF.[1] Corning incorporates by reference the facts as stated in the opinion below. The Supreme Court of Virginia thoroughly examined Corning's investment in light of the development of the "unitary business" principle through several decisions of this Court.[2] The Supreme Court of Virginia unanimously ruled that "[a]n examination of the underlying activity between [Corning] and [OCF] makes it exceedingly clear that a unitary business relationship did not exist and legally could not have existed in view of the judgment order entered in the antitrust case."[3]

## REASONS FOR DENYING PETITION

As a result of this Court's decisions in *Exxon Corp. v. Wisconsin Dep't of Revenue*, 447 U.S. 207 (1980), *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425

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[1] Appendix to Petition at 1-4, 11-13.

[2] Appendix to Petition at 5-10.

[3] Appendix to Petition at 13. The Department's assertion that the Supreme Court of Virginia effectively placed the burden on the state to prove that a unitary business existed between Corning and OCF, Petition at 8, 22, is inaccurate.

(1980), *ASARCO, supra, F.W. Woolworth Co. v. Taxation and Revenue Dept.*, 458 U.S. 354 (1982) and *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159 (1983), "[t]he legal principles defining the constitutional limits on the unitary business principle are now well established." *Container Corp.*, 463 U.S. at 176. Recognizing that the factual records involved in applying constitutional principles to "unitary business" determinations "tend to be long and complex," this Court has expressed an intention not to review "every colorable claim that a state court erred in a particular application of those principles," but rather to accept state court judgments that are "within the realm of permissible judgment." *Id.* at 176 (footnote omitted).[4]

## I. The Supreme Court Of Virginia Made A Fact-Specific Determination That Does Not Conflict With Any Decisions Of Other State Courts Of Last Resort.

The Supreme Court of Virginia properly applied the precedents of this Court to the facts before it. The Department's suggestion notwithstanding, there is no conflict between the Supreme Court of Virginia's application of *ASARCO* and other precedents of this Court to the facts before it and the application by other state courts of those same precedents to the facts before them. State courts have uniformly looked to this Court's decision in *ASARCO* as controlling precedent. In some cases, the examination of the particular facts before other state courts have led them to determine that such cases are beyond the bounds of

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[4] *See also* Petition at 11.

*ASARCO*. But the difference in outcome occasioned by this case-by-case factual analysis, was expressly anticipated by this Court in *ASARCO,supra*, 458 U.S. at 315, and is due to differences of factual underpinning, not to differences among state courts in their view of the legal principles involved.

The Supreme Court of Virginia ruled upon the facts of this case. Given the Supreme Court of Virginia's thorough and accurate analysis, it would be inappropriate to grant the Petition, and would be directly contrary to this Court's statement that it would "if reasonably possible, defer to the judgment of the state courts in deciding whether a particular set of activities constitutes a 'unitary business.' " *Container Corp., supra*, 463 U.S. at 175.

The Department erroneously asserts that there are four decisions by state courts of last resort which conflict with the decision of the Supreme Court of Virginia.[5] However, each of these cases applied this Court's analysis in *ASARCO* and related cases to the peculiar facts before them, and their analyses of *ASARCO* do not conflict with this case. Three of those cases, *Lone Star Steel Co. v. Dolan*, 668 P.2d 916 (Colo. 1983), *NCR Corp. v. Comptroller of the Treasury*, 313 Md. 118, 544 A.2d 764 (1988), and *Silent Hoist & Crane Co. v. Director*, 5 N.J. Tax 242 (N.J. Tax 1983), *aff'd*, 6 N.J. Tax 348 (N.J. Super, A.D. 1984), *rev'd* 100 N.J. 1, 495 A.2d 775, *cert. denied*, 474 U.S. 995 (1985), involved short term investments of working

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[5] Petition at 10 n.11. The Department's reference to several decisions from state courts of last resort which it concedes support the Supreme Court of Virginia's analysis, and the several decisions it cites from lower state courts in other states, need not be addressed herein. *See* S.Ct. Rule 10.1(b).

capital and not, as here and as in *ASARCO*, long term, passive ownership of stock in a discrete business enterprise. In the fourth case cited by the Department, the Supreme Court of Missouri applied the *ASARCO* principles to capital gains income, and based on the facts in that case, determined that the taxpayer and affiliated company were part of the same unitary business. *Williams Cos. v. Director*, 799 S.W.2d 602 (Mo. 1990) (en banc), *petition for cert. filed*, no. 90-1458 (March 18, 1991).[6] Thus none of the foregoing decisions is inconsistent with the application of this Court's legal principles by the Supreme Court of Virginia. The only differences among the cases are their factual bases, thus bringing to the fore this Court's holding that:

> [T]his Court will, if reasonably possible, defer to the judgment of state courts in deciding whether a particular set of activities constitutes a 'unitary business.' "

*Container Corp. of America v. Franchise Tax Board*, 463 U.S. at 175.

## II. The Supreme Court Of Virginia Fully Considered and Correctly Decided the Issues Before It.

The Supreme Court of Virginia discussed at length the legal principles established by this Court in *Exxon Corp., supra, Mobil, supra, F.W. Woolworth, supra,* and

---

[6] The court also applied *ASARCO* to interest income received from the parent which the taxpayer admitted was part of the same unitary business. *Id.*

*ASARCO, supra.*[7] The Supreme Court of Virginia examined Corning's relationship with OCF in light of both those principles and the unique facts of that case in which Corning was prohibited by an antitrust consent decree entered in federal district court from having any management or control over OCF's business activities:

> [Corning] and its employees were prohibited by court order from influencing the business operations of [OCF]. [OCF's] officers did not consult with [Corning] regarding business decisions. [Corning] did not provide financial assistance to [OCF]. [Corning] and [OCF] did not assist each other with personnel needs, or share technological or proprietary information. [Corning] and [OCF] did not engage in any bulk purchase of supplies. [Corning] did not purchase equipment for [OCF]. [Corning] and [OCF] did not use each other's distribution systems to market products. The two companies did not share any professional services. [Corning] received information about [OCF] from through public disseminations that [OCF] distributed to all its shareholders. With the exception of dividend payments [OCF] made to [Corning], there was no flow of funds between the two companies.[8]

The Supreme Court of Virginia concluded that "the 'factors of profitability' arising 'from the operation of the business as a whole' do not evidence the operation of a unitary business" between Corning and OCF.[9]

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[7] Appendix to Petition at 5-11.

[8] Appendix to Petition at 11-12.

[9] Appendix to Petition at 11.

The Department's attempts to distinguish *ASARCO* and related cases from the present case[10] were each fully considered and rejected by the Supreme Court of Virginia. The Department argues that the present case is distinguishable from *ASARCO* due to Corning's other investments, unrelated to OCF.[11] In this vein, the present

---

[10] Petition at 9-10.

[11] The Department states "[t]he [Supreme Court of Virginia] accepted but refused to attach any legal significance to the trial court's findings that . . . Corning actively managed a large portfolio of stock and investments as part of its unitary business." Petition at 7, citing Appendix to Petition at 12. The Supreme Court of Virginia only stated "[i]t is true that [Corning] had significant stock holdings in [OCF] and other corporations. However, this fact alone is not sufficient to support a legal conclusion that a unitary business relationship existed between [Corning] and [OCF]. . . . " Appendix to Petition at 12.

The Department also argues here, as it did unsuccessfully below, that the unitary business concept announced in *ASARCO* should be abandoned altogether where the subsidiary corporation is licensed to do any amount of business in the taxing state. Petition at 9-10. This Court has made clear that the critical distinction is not whether the subsidiary does any business in the taxing state, but whether the business activities of the subsidiary, wherever located, have anything to do with the business activities of the parent in the taxing state. *Mobil, supra*, 445 U.S. at 441-2. *See also*, International Paper Co. v. Taxation Division Director, 11 N.J. Tax 147, 164 (N.J. Tax 1990), James v. ITT, 654 S.W.2d 865 (Mo. 1983). The Department, in support of its proposition, cites one case, from an intermediate appellate court in New York, which is presently under appeal, Allied Signal, Inc. v. Commissioner of Finance, 562 N.Y.S.2d 76 (App. Div. 1st Dept. 1990), *appeal pending*, N.Y. Ct.App. Index No. 19702-88, and which involved a dividend payor whose headquarters were located in the taxing state.

case is identical to *ASARCO*. In *ASARCO*, the active management of some subsidiaries as part of the parent company's unitary business did not render all subsidiaries unitary.[12]

The Department also urges that the capital gains and interest income should be considered a part of Corning's unitary business because the income was "an important part of Corning's corporate strategy."[13] This is no different than the "business purpose" test which this Court has consistently rejected:

> This definition of unitary business would destroy the concept. The business of a corporation requires that it earn money to continue operations and to provide a return on its invested capital. Consequently *all* of its operations, including any investment made, in some sense can be said to be "for purposes related to the [corporation's] business." When pressed to its logical limit, this conception of the "unitary business" limitation becomes no limitation at all. When less ambitious interpretations are employed, the result is simply arbitrary.

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[12] Like Corning, ASARCO had interests in a number of subsidiaries. Six of them were wholly owned and they were found after audit to be part of the "unitary" business of ASARCO. *Id.* at 312-3. The Idaho Supreme Court upheld unitary treatment, and ASARCO did not appeal the assessments against these six subsidiaries. *Id.* at 328. ASARCO did appeal the Idaho Supreme Court's decision that income from five other companies in which it held stock was taxable as part of its unitary business. This Court found that each of these businesses were discrete business enterprises and, thus, that income from each of them was not subject to apportionment by Idaho.

[13] Petition at 20.

*ASARCO, supra,* 458 U.S. at 326 (emphasis in original). *See also F.W. Woolworth, supra,* 458 U.S. at 363-4 (The proper inquiry looks to "the underlying unity or diversity of business enterprise . . . not to whether the nondomiciliary parent derives some economic benefit – as it virtually always will – from its ownership of stock in another corporation. . . . ").

The Department argues that the size of Corning's investment in OCF alone makes OCF a part of Corning's unitary business.[14] The Supreme Court of Virginia considered and rejected this argument.[15] Further, *ASARCO* had established that a subsidiary can be a discrete business enterprise despite the parent's ownership of a substantial percentage of shares in the enterprise. *ASARCO, supra,* 458 U.S. at 321-2 (noting that ASARCO's interest in Southern Peru Copper Corp. ("Southern Peru") totaled 51.5%, but holding that ASARCO's investment in Southern Peru was not part of ASARCO's unitary business).[16]

The Supreme Court of Virginia applied the correct and long established legal standard to the unique factual record of this case. Its resulting unanimous decision was "within the realm of permissible judgment." *Container Corp.,* 463 U.S. at 176 (footnote omitted). Petitioner's claim that the Supreme Court of Virginia wrongly applied this Court's precedent is in error and does not merit review by this Court.

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[14] Petition at 20.

[15] Appendix to Petition at 12.

[16] Corning owned 24% of the common stock of OCF during the relevant period. Appendix to Petition at 4.

## CONCLUSION

For the foregoing reasons, the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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July 3, 1991

FILED
JUL 1 1991
OFFICE OF THE CLERK

No. 90-1852

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1991

COMMONWEALTH OF VIRGINIA,
DEPARTMENT OF TAXATION,
*Petitioner*,

v.

CORNING GLASS WORKS, INC.,
*Respondent*.

**On Petition for a Writ of Certiorari to the Supreme Court of Virginia**

## BRIEF OF ARKANSAS, CONNECTICUT, DELAWARE, ILLINOIS, INDIANA, IOWA, MARYLAND, MICHIGAN, MINNESOTA, NEW HAMPSHIRE, NEW JERSEY, NEW MEXICO, NORTH CAROLINA, NORTH DAKOTA, PENNSYLVANIA, SOUTH CAROLINA, UTAH, VERMONT, WEST VIRGINIA, AND WISCONSIN, AS AMICI CURIAE IN SUPPORT OF PETITIONER

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## BRIEF OF ARKANSAS, CONNECTICUT, DELAWARE, ILLINOIS, INDIANA, IOWA, MARYLAND, MICHIGAN, MINNESOTA, NEW HAMPSHIRE, NEW JERSEY, NEW MEXICO, NORTH CAROLINA, NORTH DAKOTA, PENNSYLVANIA, SOUTH CAROLINA, UTAH, VERMONT, WEST VIRGINIA, AND WISCONSIN, AS AMICI CURIAE IN SUPPORT OF PETITIONER

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### INTRODUCTORY STATEMENT

Pursuant to United States Supreme Court Rule 37.2, the signatory states submit this Brief as Amici Curiae in support of Virginia's Petition for a Writ of Certiorari. Because this Brief is sponsored and filed by the aforementioned states, consent to its filing is not required. U.S. Sup. Ct. R. 37.5.

## INTEREST OF AMICI CURIAE

This case concerns the due process legal standards governing the allocation of authority among the states to tax income from intangibles. Under the "unitary business principle," each state in which a corporation operates has the right to tax, on a fairly apportioned basis, the corporation's entire net income from unitary business activities. This federal judicial concept defines the scope of nondomiciliary states' authority to tax foreign corporations and, therefore, is applicable to Amici because they impose apportioned income taxes based on formulas measuring the taxpayer's in-state activities.[1]

The signatory Amici believe that the Virginia Supreme Court's decision in this case incorrectly interprets *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982) ("*ASARCO*") to remove income from intangibles from the apportionable income base unless the state can prove a unitary business relationship between the income-payor and the income-recipient. This overly restrictive approach ignores the presumptively unitary character of a single corporation's income and activities. Moreover, such an approach virtually assures that a significant portion of a corporation's income will escape all state taxation, notwithstanding the benefits conferred by the several states upon the corporations conducting their businesses within the states' borders. The Amici urge this Court to grant the writ to decide the proper legal standards to apply in determining the apportionability of income from intangibles, an issue of sufficient importance and general applicability to warrant the grant of certiorari. The many divergent state court interpretations of *ASARCO* have created confusion and uncertainty for taxpayers, Amici States and other States alike.

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[1] The State of Michigan does not impose an income tax, but does impose an apportioned value-added tax which includes capital gains in the tax base.

## SUMMARY OF ARGUMENT

State courts of last resort have interpreted *ASARCO* in conflicting ways, applying drastically different legal standards in determining whether the federal due process clause permits apportionment of income from intangibles. The lack of uniformity concerning the due process legal standards governing application of the unitary business principle to income from intangibles creates inequities and problems for states and taxpayers. The unitary business principle, as a federal judicial concept, should have a uniform interpretation that only this Court can provide.

The Virginia Supreme Court and some other courts have interpreted *ASARCO* in a way that overly restricts the power of the states to tax income from intangible assets. Other courts have appropriately limited *ASARCO* to its facts. Therefore, this case involves an important question of federal law that needs to be settled by this Court so as to give guidance to state courts with respect to the application of the federal unitary business principle.

## ARGUMENT

### I. INTRODUCTION: THE UNITARY BUSINESS PRINCIPLE

The unitary business principle is a federal judicial concept initially applied to sustain apportioned state taxation of interstate railroad property. *See State Railroad Tax Cases*, 92 U.S. 575 (1875). The concept was later extended to state corporate income taxes where it has been used for two distinct purposes: (1) to measure the entire net income of a single corporation from all activities deemed to constitute part of a single unitary business enterprise; and (2) to combine the income of two or more separate corporations deemed to constitute a single business enterprise. *See U. S. Steel Corp. v. Multistate Tax Comm'n*, 434 U.S. 452, 473 n. 25 (1978).

This case concerns the first of these purposes and addresses the application of the unitary business principle to measure the entire net income of a single integrated glass manufacturing company from its unitary stock ownership activities. Presumptively all of the income of a single corporation is unitary and apportionable. *See Exxon Corp. v. Wisconsin Dep't of Revenue*, 447 U.S. 207, 219 (1980) (*"Exxon"*); *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425, 436 (1980) (*"Mobil"*). Due process requires only that there be (1) a "minimal connection" or nexus between the interstate activities and the taxing state, and (2) a "rational relationship" between income attributed to the state and the intrastate values of the enterprise. *Trinova Corp. v. Michigan Department of Treasury*, —— U.S. ——, 111 S.Ct. 818, 828 (1991) (quoting *Mobil*, 445 U.S. at 443). *See also Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444-45 (1940) (*"J.C. Penney"*). It is the taxpayer's burden to prove by "clear and cogent evidence" that the constitutional requirements are not met. *Trinova*, 111 S.Ct. at 832 (citations omitted).

The original rationale for the unitary business principle was the difficulty of identifying the geographic source of the income earned by a multistate enterprise. *Trinova*, 111 S. Ct. at 829. Factors contributing to this difficulty include functional integration, centralization of management and economies of scale. *Id.* at 832. Because of the impracticability of assuming that all income can be assigned to a single source, the unitary business principle

> rejects geographical or transactional accounting, and instead calculates the local tax base by first defining the scope of the "unitary business" of which the taxed enterprise's activities in the taxing jurisdiction form one part, and then apportioning the total income of that "unitary business" between the taxing jurisdiction and the rest of the world on the basis of a formula taking into account objective measures

> of the corporation's activities within and without the jurisdiction.

*Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 165 (1983) ("*Container*").

Under the unitary business principle, the fact that the source of particular income may be ascertained by separate geographical accounting is constitutionally irrelevant. So long as the income-producing activity is part of a unitary business, the income is includable in the apportionable income base. *Trinova*, 111 S. Ct. at 831 (quoting *Mobil*, 445 U.S. at 438); *Amerada Hess Corp. v. Director*, 490 U.S. 66, 73 (1989) (fact that activity occurring entirely outside the state is conducted by a unitary business establishes a substantial connection satisfying nexus requirement).

## II. ASARCO HAS PRODUCED SUBSTANTIAL CONFLICT

While the general contours of the unitary business principle are well established, state appellate courts fundamentally disagree on the legal standards applicable when the income sought to be apportioned arises from intangible assets, particularly capital stock. The focal point of disagreement is this Court's decision in *ASARCO*. Interpretations of *ASARCO* range from a narrow, fact-specific view to the extremely broad view of the Virginia Supreme Court in this case. Some courts have interpreted *ASARCO* to prescribe an exclusive bright-line test which mandates a unitary business relationship between the income-payor and the income-recipient as a prerequisite to taxing income from intangibles. The Virginia Supreme Court applied this incorrect legal standard in this case. Other courts have appropriately limited *ASARCO* to its own peculiar facts and have gone further to determine whether the income-producing asset or activity is part of a single corporation's unitary business.

*ASARCO* concerned the authority of the State of Idaho to include certain income from intangibles (capital stock) in the apportionable income base of a nondomiciliary corporation that conducted a unitary nonferrous metals business in part within Idaho. The income in question consisted primarily of dividends paid by five foreign corporations having no contacts with Idaho. Minor amounts of capital gains and interest from ASARCO's sale of its stock in two of the corporations were also involved. *Id.* at 310.[2]

On these facts, this Court reversed the decision of the Idaho Supreme Court sustaining the apportionability of the income in question. In so holding, the majority specifically relied on the state trial court's findings that ASARCO

> "has never been required to utilize its stock as security for borrowing of working capital, acquiring stock or securities in other companies or to support any bond issues." Moreover, ASARCO was found to have "sufficient cash flow from mining to provide operating capital for all mining operations without reliance upon cash flow from . . . income from intangibles."

458 U.S. at 325 n.21 (quoting from the trial record).

The foregoing passage from *ASARCO* lies at the heart of the conflict between state court decisions involving the apportionability of income from intangibles. Courts fundamentally disagree on the significance of facts concern-

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[2] The joint appendix in *ASARCO* reflects that over 90% of the income at issue was the foreign subsidiaries' dividend payments. *ASARCO* also involved minor amounts of capital gains and interest that ASARCO received from its sale of two of the "subsidiaries'" stock. *See* 458 U.S. at 329-30. The stock apparently was sold to unrelated third parties. Neither the majority nor the dissent attaches significace to the identity of the "payors" of ASARCO's capital gains and interest since Idaho conceded that the treatment of the dividends would control the treatment of the capital gains and interest. *See id.* at 330. The Virginia Supreme Court has now elevated Idaho's concession to constitutional doctrine.

ing the role of the income-producing asset or activity in the taxpaying corporation's business. The Amici maintain that if facts show that the income-producing asset or activity has an operational function in the taxpaying corporation's unitary business, such facts are relevant and demonstrate the apportionability of the income in question. *See ASARCO*, 458 U.S. at 325 n.21, 327 n.22; *Container*, 463 U.S. at 180 n.19.[3]

In contrast to the decision below, courts of last resort in other states have held that income from intangibles is apportionable if the facts establish that the income is generated by investments that are used to advance the operations of the unitary business. For example, in *NCR Corporation v. Comptroller*, 313 Md. 188, 544 A.2d 764, 770-75 (1988), the Maryland Court of Appeals reversed the decision of the trial court which relied on *ASARCO* to exclude interest from apportionment. The Court of Appeals stated:

> What is important about *ASARCO* is its factual foundation. The subsidiaries in question there were discrete business enterprises, that is, they had no connection whatsoever with ASARCO's Idaho activities.

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[3] Several leading commentators in this area have concurred:

> interest and dividends are properly apportionable to the recipient, irrespective of whether the payor is part of the taxpayer's unitary business being carried on in the taxing State, if the stocks or obligations on which the dividends or interest are being paid constitute assets employed by the taxpayer in its unitary business.

Hellerstein, *State Taxation: I Corp. Income & Franchise Taxes* § 9.12[3] at S300 (Cum. Supp. 1989).

> all income should be apportioned to the extent that it is derived from investments that further the unitary business of the taxpayer. Cardinal examples [include] . . . investments made to expand business operations . . . . In all of these examples, the nature of the investment and the relationship of the investor to the business or activity invested in by the taxpayer are totally immaterial.

Dexter, *The Unitary Business Principle Revisited: Restrictions on Its Use*, 8 J. St. Tax'n 205, 213 (1990).

> The interest payers here involved were also not part of NCR's business machine enterprise, nor were they controlled by NCR. But to paraphrase *Mobil*, only if "the income was earned in the course of activities unrelated to [NCR's unitary activities in Maryland]" would Maryland be prevented from taxing it.
>
> * * * *
>
> The evidence before the Tax Court did not show that the investments which produced the DPI [interest] were passive. They were actively monitored and carefully timed so as to meet NCR's operating needs. And they did not arise out of a distinct business operation—that is, a money-lending operation, as opposed to the business machine business.

544 A.2d at 772, 774. In this case, the state trial court correctly applied this same fact-based view of *ASARCO*, only to be reversed by the Virginia Supreme Court.

The New Jersey Supreme Court applied a similar fact-based analysis in *Silent Hoist & Crane Co. v. Director*, 100 N.J. 1, 494 A.2d 775, *cert. denied*, 474 U.S. 995 (1985) which concerned the apportionability of a single corporation's portfolio investment income from various nonunitary enterprises. The New Jersey Supreme Court held that the income was apportionable because the investment activity was one of several centrally managed unitary business activities of a single corporation.[4]

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[4] Other courts have utilized similar analyses in determining the apportionability of income from intangibles. *Bendix Corp. v. Director*, 10 N.J. Tax 46 (1988), *aff'd*, 237 N.J. Super. 328, 568 A.2d 59 (1989), *appeal pending* N.J. Sup. Ct. No. 31, 140; *M. Lowenstein Corp. v. South Carolina Tax Comm'n*, 298 S.C. 93, 378 S.E. 2d 272, 276-78 (Ct. App. 1989); *Lone Star Steel Co. v. Dolan*, 668 P.2d 916, 924-25 (Colo. 1983). *Contra, e.g., James v. Int'l Tel. & Tel. Corp.*, 654 S.W.2d 865 (Mo. 1983); *Mobil Oil Corp. v. Director*, 11 N.J. Tax 344 (1990), *appeal pending*, N.J. Super. Ct. App. Div. No. A-2326-90-T5. *See also International Paper Co. v. Taxation Division Director*, 11 N.J. Tax 147 (1990), *aff'd*, —— N.J. Tax —— (App. Div. 1991) (Bard stock issue). One need look no further than the cited New Jersey decisions to see the difficulties state courts

The recent decision of the Missouri Supreme Court in *Williams Cos. v. Director*, 799 S.W.2d 602 (Mo. 1990), *petition for cert. filed* Mar. 18, 1991, Docket No. 90-1458, appropriately recognizes that there are at least *two* tests of apportionability applicable to income from intangibles. The Missouri Supreme Court held that income from intangibles is unitary and apportionable if *either* the income-producing asset or activity is part of the taxpayer's unitary business *or* if the taxpayer and the income-payor corporation are a unitary business. Thus, the court in *Williams* held that interest on intercorporate loans was unitary and apportionable even though managing funds was not an integral part of the lender's business because the lending subsidiary and the parent company payors were parts of a unitary business. 799 S.W.2d at 606. Capital gains from preferred stock in an independent company engaged in the same line of business, on the other hand, were held apportionable because the investment was part of the taxpayer's unitary business. *Id.* at 607.

## III. OWNING STOCK CAN BE A UNITARY BUSINESS ACTIVITY

The bright-line unitary payor/payee test applied by the Virginia Supreme Court ignores the fact that most businesses fall along a continuum somewhere between the paradigms of a highly integrated business which bene-

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have in trying to apply the principles of *ASARCO* and *Container* to the cases before them. Compare *e.g.* the majority opinion of the New Jersey Tax Court in *International Paper*, 11 N.J. Tax at 163, finding the facts relating to the Bard stock to be analogous to those in *ASARCO* with the dissenting opinion which relied on *Container Corp.* to conclude that there was a sharing of value sufficient to make the capital gain on the Bard stock unitary. 11 N.J. Tax at 172. The lower courts' inability to develop coherent legal principles which would provide focus to the intensely factual unitary business inquiries results in a tremendous burden upon taxpayers and state tax officials alike.

fits from an umbrella of centralized management and controlled interaction on the one hand, and a highly decentralized conglomerate consisting of many diverse businesses on the other. *See* P. Hartman, *Federal Limitations on State and Local Taxation*, § 9.30, at 445 (Supp. 1990).[5]

Requiring a unitary payor as a constitutional prerequisite to apportionability unduly limits application of the unitary business principle to businesses fitting the high integration model and improperly excludes income from intangibles from the apportionable income base. Under the Virginia Supreme Court's overly broad reading of *ASARCO*, even a highly integrated and centrally managed business like Corning may exclude interest and stock gains from apportionment if the state cannot prove a unitary business relationship with the income-payor. There is no basis in the constitutional text or this Court's decisions to support such an exclusion. If the corporation's stock ownership activities are part of its unitary business and not a discrete business enterprise, the income from the stock is includable in the corporation's apportionable income base. *See Mobil*, 445 U.S. at 439-40.

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[5] A business may be vertically or horizontally integrated for purposes of assessing its unitariness. *See Macy & Co. v. Lindley*, 25 Ohio St.3d 218, 495 N.E.2d 948, 950 n.1 (1986), where the court stated:

> "Vertical integration" refers to a business organized into separate divisions, each performing an entirely separate function, such as production, marketing and retailing of the same product. Horizontal integration describes a business where each division performs basically the same function in different locations—for example, a retail chain.

*See also* P. Hartman, *supra*, at 412 n.17 (explaining three types of integration identified in U.S. Supreme Court opinions—(1) functional or vertical integration; (2) managerial integration or contralization of management; and (3) horizontal integration or economies of scale).

This Court's decision in *Container* leaves no doubt that owning stock can be a unitary business activity. A corporation's ownership of stock in other corporations can serve either an investment function or an operational function. *Container*, 463 U.S. at 180 n.19 (citing *Corn Products Refining Co. v. Comm'r*, 350 U.S. 46, 50-53 (1955)). When, as in *Corning*, the investment is made in a corporation engaged in a related line of work, "it becomes much more likely that one function of the [stock] investment is to make better use—either through economies of scale or through operational integration or sharing of expertise—of . . . existing business-related resources." *Container*, 463 U.S. at 178. Moreover, investments in corporations engaging in different lines of business 'often serve[] the primary function of diversifying the corporate portfolio and reducing the risks inherent in being tied to one industry's business cycle." *Container*, 463 U.S. at 178. Whenever the stock ownership activity serves an operational function in the investor's unitary business—*e.g.*, if the stock is used to provide income for operations, if it is used as security to borrow working capital, acquire stock or securities in other companies or to support bond issues (*see Container*, 463 U.S. at 180 n.19; *ASARCO*, 458 U.S. at 325 n.21)—the stock ownership activity is unitary and the resulting income apportionable. *See* P. Hartman, *supra*, at 441 (a "taxpayer's investments may be so integrally involved in the taxpayer's own business operations that the income should be included in the payee's apportionable tax base" "without any requirement of functional integration or centralized control of payor and payee") (quoting W. Hellerstein, *State Income Taxation of Multijurisdictional Corporations, Part II: Reflections on ASARCO and Woolworth*, 81 Mich. L. Rev. 157, 181 (1982)).

What is relevant in the case of a centrally managed corporation like Corning is the function of the stock ownership activity in the taxpaying corporation's unitary business. In Corning's case, owning stock in related cor-

porations served a variety of unitary business purposes—repaying loans, issing debentures, diversification, expansion, developing new markets, learning new technologies. This centrally managed unitary stock ownership activity was no less unitary than Corning's sales of glassware products. Income from all unitary business activities—owning stock, manufacturing and selling glass products—is apportionable regardless of the taxpayer's relationship to the income-payor.

## IV. THE VIRGINIA SUPREME COURT'S INTERPRETATION PROMOTES TAX AVOIDANCE

Including income from intangibles in the apportionable income base creates no risk of distortion or extraterritorial taxation. Adjustments to the three-factor apportionment formula are the appropriate remedy for concerns about unfair distortion or extraterritorial taxation, which the taxpayer must prove by clear and cogent evidence. See *Trinova*, 111 S. Ct. at 832. *See also Shell Oil Co. v. Dep't of Revenue*, 488 U.S. 19, 30-31 (1988) (mere inclusion of income in preapportioned tax base does not establish extra-territorial taxation).[6]

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[6] For example, it has been suggested that including *dividends* paid by foreign corporations in the apportionable income base of the recipient corporation creates a risk of unfair distortion because the foreign corporation's property, payroll and sales are not reflected in the denominator of the apportionment formula. See *Mobil*, 445 U.S. at 461 (Stevens, J., dissenting); *Container*, 463 U.S. at 168 n.5; *NCR*, 544 A.2d at 775, 778, 781; P. Hartman, *supra*, at 442 (noting possible confusion of criteria for apportionment and combined reporting).

This case, however, concerns only capital gains and interest resulting from Corning's business decision to liquidate its substantial Owens Corning Fiberglass stock asset. Unlike dividends which are the product of another corporation's business decisions and activities, capital gains and interest are the product of the asset owner's decision to sell the asset. There is, therefore, no basis for adjusting the apportionment formula to reflect the asset-purchaser's property, payroll and sales.

Excluding income from intangibles unless the state can prove a unitary income-payor creates—indeed virtually guarantees—a significant opportunity for tax-avoidance. It is "to eliminate from the reach of the taxing power a large portion of the wealth of the country." *Adams Express Co. v. Ohio State Auditor*, 166 U.S. 185, 219 (1897). State tax officials are naturally at a disadvantage when it comes to unraveling the complexities of multistate, multinational, multicorporate transactions. Requiring states to prove a unitary income-payor creates an incentive for corporations to structure transactions so as to insure payment by non-unitary payors. Moreover, placing the burden of proof on the state tax officials to prove the existence of a unitary business is directly contrary to this Court's instruction in *Container*, 463 U.S. at 164, where the Court required the corporation to prove "by clear and cogent evidence" that extraterritorial values were being taxed. *See also, Mobil*, 455 U.S. at 442 (corporation failed to sustain its burden of proving that dividend income was derived from unrelated business activity).

Inconsistent interpretations of *ASARCO* also create a risk that some taxpayers will be subjected to multiple taxation on their income from intangibles, whereas others will avoid taxation entirely. For example, a taxpayer domiciled in a state adopting a broad interpretation of *ASARCO* may be fully taxed on its income from intangibles by its state of domicile even though the same income is taxed on an apportioned basis by other states that adopt a narrower, fact-based view of *ASARCO*. Conversely, a corporation may be exempt from tax in its state of domicile yet also able to avoid fairly apportioned taxation in states like Virginia where the corporation operates under overly broad interpretations of *ASARCO*. A uniform interpretation by this Court is needed to put an end to what is both an inherent inconsistency and an opportunity for corporate-structured tax avoidance.

The unitary business principle was developed to facilitate, not frustrate, legitimate state taxation. As this Court held over a half century ago in *J.C. Penney*, the constitutional due process test

> is whether property was taken without due process of law, or, if paraphrase we must, whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return.

311 U.S. at 444-45.

A state that confers on a taxpayer the substantial privilege of carrying on business is entitled to tax all of the unitary business' income, including income from intangibles, on a fairly apportioned basis. *Id.* at 445-46. *Accord*, *Mobil*, 445 U.S. at 445-46.

## CONCLUSION

Virginia's Petition raises issues with a significant impact in the field of state taxation of income that are of vital concern to the Amici. The Petition raises important questions of federal law which have not been, but should be, settled by this Court. Those questions of federal law have been decided by the Virginia Supreme Court in a way that conflicts with decisions of other state courts of last resort and misapplies the decision of this Court in *ASARCO*. Therefore, we urge this Court to grant Virginia's Petition for a Writ of Certiorari and to give plenary consideration to the matter.

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No. 90-1852

Supreme Court, U.S.
FILED
JUL 19 1991
OFFICE OF THE CLERK

In The

# Supreme Court of the United States

October Term, 1991

COMMONWEALTH OF VIRGINIA,
DEPARTMENT OF TAXATION,

*Petitioner,*

v.

CORNING, INC.,

*Respondent.*

**On Petition For A Writ Of Certiorari To The Supreme Court Of Virginia**

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On Petition For A Writ Of Certiorari
To The Supreme Court Of Virginia

## REPLY BRIEF FOR THE PETITIONER

## INTRODUCTION

Pursuant to this Court's Rule 15.6, the Attorney General of Virginia, on behalf of the Commonwealth's Department of Taxation ("Virginia"), respectfully submits this Brief in response to the Brief In Opposition ("Opposition") to its Petition for Writ of Certiorari ("Petition") that was filed by Corning, Inc. ("Corning"). With respect to matters not addressed herein, Virginia relies on its Petition.

Virginia's Petition argues that certiorari is appropriate because the Supreme Court of Virginia applied an erroneous legal standard in reversing the judgment of the state trial court. That erroneous legal standard, Virginia argued (Pet. 8-14),[1]

[1] "Pet.," "Pet. App.," "Opp." and "Am. Br." references are to Virginia's Petition, the Appendix to Virginia's Petition, Corning's Opposition and the supporting States' Amicus Brief, respectively.

directly conflicts with the decisions of sister state appellate courts and erroneously resolves important federal constitutional issues left open in *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982) ("*ASARCO*").

Twenty states joined an amicus brief filed by the State of Maryland supporting Virginia's Petition for Certiorari. Like Virginia's Department of Taxation, tax officials in these states need authoritative guidance from this Court on the proper scope and application of this Court's decision in *ASARCO* to income from intangibles.

## I. Virginia And Twenty Amici States Seek Certiorari To Resolve Important Issues Of Federal Constitutional Law Affecting The Taxation Of Multistate Corporations That Receive Income From Intangibles

Corning's opposition essentially fails to respond to Virginia's and amici's argument that the Supreme Court of Virginia misinterpreted *ASARCO* to prescribe a single bright-line test for determining the apportionability of income from intangibles. Instead, Corning disingenuously attempts to downplay the significance of this case by suggesting (Opp. 3) that the Virginia Supreme Court made a "fact-specific" determination.[2] Corning is wrong. The Virginia Supreme Court reversed the trial court's fact-specific determination based on its view of the law, specifically its interpretation of *ASARCO*. The Virginia Supreme Court interpreted *ASARCO* to mandate application of a single bright-line test requiring a unitary business relationship between the income-payor and the income-recipient *regardless* of where the income-payor

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[2] The significance and general applicability of this case were obvious to Corning and members of the business community in seeking reversal of the Virginia trial court's decision. The Committee on State Taxation of the Council of State Chambers of Commerce ("COST") and two major corporations, W. R. Grace & Co. and Lorillard Inc., filed amicus briefs supporting Corning's position in the Virginia Supreme Court.

does business and *regardless* of the function of the income-producing asset or activity in the taxpayer's unitary business.[3]

Virginia and amici seek review by this Court not to argue about disputed facts but to obtain guidance concerning the legal standards applicable to apportioning income from intangibles. The only "fact" relied on by the Virginia Supreme Court was the undisputed fact that a 1949 federal antitrust consent decree prevented Corning from directly controlling Owens Corning Fiberglas Corporation ("OCF"). The Virginia Supreme Court held this single, undisputed fact controlling because it misread *ASARCO* to ignore all other facts. But, as Virginia and its twenty amici states agree (*see* Am. Br. 9-12), this single fact alone cannot legally be controlling unless the unitary business inquiry focuses solely on the relationship between the income-payor and the income-recipient. It does not.

## II. The Virginia Supreme Court Applied An Erroneous Legal Standard That Directly Conflicts With The Decisions Of Other State Courts Of Last Resort

Virginia and amici seek an affirmation by this Court that there are at least two tests governing the apportionability of income from intangibles, *i.e.*, such income is apportionable if either the income-producing asset or activity is part of the taxpayer's unitary business or the taxpayer and the income-payor corporation are a part of a larger unitary business. *See* Pet. 17-18; Am. Br. 9.

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[3] Corning's suggestion (Opp. 5) that the Virginia Supreme Court "fully considered" the issues before it ignores the fact that the court's opinion does not even mention the contrary state appellate decisions and commentators supporting the trial court's decision. *Compare Pledger v. Illinois Tool Works, Inc.*, No. 90-242, slip op. (Ark. Sup. Ct. June 24, 1991) (1991 ARK LEXIS 333) (Hays, J. dissenting) (recognizing unsettled state of cases). Corning's assertion (Opp. 5) that the Virginia Supreme Court "correctly" decided the issues before it ignores the fact that the court's opinion erroneously cites *ASARCO* as concluding that *no* unitary business relationship existed between ASARCO and five wholly-owned and controlled subsidiaries. *See* Pet. App. 8.

Corning seeks to distinguish three of the state appellate court decisions supporting the trial court's finding that Corning's OCF investment was part of Corning's unitary business by asserting that these cases involve "short term investments of working capital" (*see* Opp. 4-5).[4] Corning's suggestion lacks merit. Nowhere do the appellate courts' opinions in these cases suggest that apportionability should depend on the duration of the asset holding period or the term of the deposit or loan generating the interest. Rather, the controlling facts were those concerning the *function* of the income-producing asset or activity and its relationship to other activities of the taxpayer's unitary business.[5]

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[4] Corning asserts (Opp. 4 n.5) that it need not respond to the many hopelessly conflicting lower state court decisions Virginia has cited (Pet. 9 n.10, 10 n.11, 12 n.13). Certiorari, of course, is appropriate in this case to resolve precisely such nationwide conflict.

[5] *See NCR Corp. v. Comptroller*, 313 Md. 118, 134, 140, 544 A.2d 764, 772, 774 (1988) ("the focus of the inquiry is on the relationship of the activity in question with the unitary business, not on the identity of the business payer"; "the investments which produced the DPI [interest income] . . . were actively monitored and carefully timed so as to meet NCR's operating needs"); *Silent Hoist & Crane Co. v. Director*, 100 N.J. 1, 19, 23, 494 A.2d 775, 784, 786, *cert. denied*, 474 U.S. 995 (1985) ("[t]he focus must be on Silent Hoist's investment activity and other aspects of its corporate business and the role the investment activity plays in those other activities"; "We are more than satisfied here that there was a distinct sharing of the value of common management, accounting and operations that takes the portfolio income of this taxpayer well within the concept of a unitary business"); *Lone Star Steel Co. v. Dolan*, 668 P.2d 916, 925 (Colo. 1983) (Lone Star "is engaged in only one business – the integrated steel business – and it lends money to its parent in furtherance of the goals, and to aid the operations, of its unitary business").

Corning seriously misstates the holding of the Missouri Supreme Court in *Williams Cos. v. Director*, 799 S.W.2d 602 (Mo. 1990), *cert. denied*, 59 U.S.L.W. 3866 (U.S. Sup. Ct. June 28, 1991), with respect to the capital gains income at issue in that case. The capital gains arose from the sale of stock in a separate corporation (Wood River Pipeline Company), which was formed as a joint-venture between the

(Continued on following page)

Indeed, Corning's concession that short-term investments of working capital produce apportionable income is fundamentally inconsistent with Corning's position that *ASARCO* prescribes a single bright-line unitary income-payor/recipient test. The apportionability of such income derives not from the short-term nature of the investment or the identity of the income-payor, but from the direct relationship between the investment activity and the operation of the business. Moreover, the *longer* the holding period, the more likely it is that the asset is related to or utilized in the operation of the business, facts the Court in *ASARCO* indicated *could* establish a unitary business relationship. *See* 458 U.S. at 325 n.21.

The error of Corning's reasoning is demonstrated by the recent opinion of the New Jersey Supreme Court in *Bendix Corp. v. Director,* No. A-47, slip op. (N.J. Sup. Ct. July 16, 1991) (1991 NJ LEXIS 72) ("*Bendix*"), which sustained the very position urged by Virginia and amici here. Affirming the lower courts' conclusion that the capital gains and interest income of a nondomciliary corporation from the sale of its minority (20.6%) stock interest in ASARCO, Inc. was includable in New Jersey's apportionable income base,[6] the New Jersey Supreme Court stated:

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(Continued from previous page)

taxpayer and a Minnesota refinery operator (Koch Industries, Inc.). 799 S.W.2d at 606. The taxpayer Williams Pipeline Company did not actually control or operate Wood River Pipeline Company, but instead held preferred stock that was ultimately sold to the other joint venturer (Koch). The Missouri Supreme Court held that the capital gains income was apportionable because "[the taxpayer] Williams Pipeline Company's *interest* in Wood River Pipeline Company *was a part of Williams Pipeline Company's unitary business.*" *Id.* at 607 (emphasis added).

By contrast, certain interest income from short term loans to parent companies was held apportionable because the taxpayers conceded that the parent company payors were all part of the same unitary business. *Id.* at 606. The *Williams Cos.* case, therefore, supports Virginia's and amici's position that there are a number of nonexclusive tests governing the apportionability of income from intangibles.

[6] *See Bendix Corp. v. Director,* 10 N.J. Tax 46 (1988), *aff'd,* 237 N.J. Super. 328, 568 A.2d 59 (1989).

> [T]here are a number of nonexclusive tests utilized to determine the existence of a unitary business.
>
> * * *
>
> The tests for determining a unitary business are not controlled . . . by the relationship between the taxpayer recipient and the affiliate generator of the income that becomes the subject of State tax. As has been emphasized, there is no bright line controlling test. What controls is the underlying activities that reflect the economic realities of the corporate business.
>
> * * *
>
> Bendix, during the period under review, essentially had a business function of corporate acquisitions and divestitures that was an integral operational activity.
>
> * * *
>
> When capital investment activities are long-term integral operational corporate functions rather than passive investment functions, they can serve as the basis for concluding a unitary business exists.

*Bendix*, slip op. at 16, 18-20.[7]

Like Bendix's interest in ASARCO, there can be no doubt that Corning's interest in OCF was part of Corning's unitary business, as the Virginia trial court correctly found. As the listing of parties on pages ii and iii of Corning's Opposition indicates, one of the principal activities of Corning's unitary business is investing in subsidiary and associated companies. *See Corning's Class Act – How Jamie Houghton Reinvented the Company*, Bus. Wk. 68-76 (May 13, 1991). Corning did not establish a separate holding company for this purpose, but has always conducted its stock ownership activities as an indivisible part of its unitary business.

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[7] The New Jersey Supreme Court also sustained the apportionability of capital gains and interest from Bendix's sale of its 100% stock ownership in United Geophysical Corporation ("UGC"). *See Bendix*, slip op. at 8-10, 23. *Compare id.* at 8 (noting that Bendix and ASARCO "shared no common officers, employees, office space, or legal services" etc.).

The OCF stock was a fundamental part of Corning's operating strategy for nearly half a century. It is not merely the size of the OCF investment (it constituted about one-sixth of Corning's net worth over a thirty-year period), but also the continuity and regularity of Corning's stock investment activities and its dependence on those activities to support and expand its core glass manufacturing business that fully support the trial court's finding of apportionability. As the majority in *ASARCO* stressed, the facts found by the trial court in that case were entirely different:

> The trial court, however, found that ASARCO "has never been required to utilize its stock as security for borrowing of working capital, acquiring stock or securities in other companies or to support any bond issues." Moreover, ASARCO was found to have "sufficient cash flow from mining to provide operating capital for all mining operations without reliance upon cash flow from . . . income from intangibles."

458 U.S. at 325 n.21 (quoting from the trial record).

## III. There Is A Significant Need For Clarification Of The Scope Of *ASARCO* And The Due Process Legal Standards Governing The Apportionability Of Income From Intangibles

As noted, Corning's basic response strategy is to deny the significance of this case.[8] Rather than respond to Virginia's

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[8] Corning also seeks to downplay the significance of OCF's operation in Virginia (*see* Opp. 7 n.11). But *ASARCO* is by its terms inapplicable to income paid by corporations operating within the taxing state. *See ASARCO*, 458 U.S. at 308-09. The undeniable fact of OCF's operation in multiple states, including Virginia, Ohio and New York, demonstrates the unreasonableness of the result reached by the Virginia Supreme Court. As Corning cannot deny, New York does not fully tax income from intangible assets. *See* Pet. 16 n.16. Thus, Corning does not suggest that New York fully taxed the income in question or that Virginia and New York together seek to tax more than 100% of the capital gains and interest. Rather, Corning asks this Court to deny certiorari by constructing "straw man" arguments that grossly oversimplify and misstate Virginia's and the amici's position – there is no single bright-line test for determining the apportionability of income from intangibles.

argument that Corning's stock ownership activities, including its activities with respect to the OCF stock, served an operational function in Corning's unitary business, Corning instead asserts (Opp. 8) that Virginia's reliance on the "importan[ce]" of the capital gains and interest income in Corning's corporate strategy amounts to no more than a "business purpose" test rejected in *ASARCO* and a companion case, *F.W. Woolworth Co. v. Taxation and Revenue Dep't.*, 458 U.S. 354 (1982). Corning's argument not only overlooks significant activities *preceding* the sale of the OCF stock, but also a significant legal development, *i.e.*, this Court's explicit recognition in *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983) ("*Container*"), that capital transactions may serve an *operational function*. *See* 463 U.S. at 180 n.19. *Accord Bendix*, slip op. at 20.

The reason for Corning's silence on these points is obvious. Corning cannot deny what the record clearly establishes: that Corning's stock ownership activities, including its activities with respect to the OCF stock, served a variety of key operational purposes in Corning's unitary business, such as issuing debt, repaying loans, diversification, cyclical protection, expansion into new product lines, funding programs in glass and ceramics, technological development and financing a major corporate reorganization. *See* Pet. 9 n.9.

To describe these integral business activities as "passive ownership of stock in a discrete business enterprise" (*see* Opp. 5) not only ignores reality, it fundamentally distorts the purpose of the unitary business concept. The concept is not a sword to enable taxpayers to carve out exemptions for major accretions to wealth such as the capital gains and interest exceeding $100 million at issue here. The concept is designed to facilitate legitimate state taxation by freeing states from the artificial constraints of geographical or transactional accounting. *Container*, 463 U.S. at 165.

Capital stock investments that serve an operational function in the investor's unitary business (*e.g.*, obtaining loans for operating capital, supporting bond issues or acquiring

stock or securities in other companies) provide income that is fully apportionable. *See ASARCO*, 458 U.S. at 325 n.21; *Container*, 463 U.S. at 180 n.19. As the New Jersey Supreme Court recently concluded, "[w]hen capital investment activities are long-term integral operational corporate functions rather than passive investment functions, they can serve as the basis for concluding a unitary business exists." *Bendix*, slip op. at 20 (citing *Container*). *See Container*, 463 U.S. at 166 (unitary business relationship between in-state and out-of-state activities is established by "some sharing or exchange of value . . . beyond the mere flow of funds arising out of a passive investment or a distinct business operation"). *See also supra*, note 5.

In this case, Corning wholly failed to, and indeed could not, meet its burden of proving that it had no need to rely on the OCF stock investment, which accounted for one-sixth of Corning's net worth over a 30-year period and which was liquidated to finance a major restructuring of Corning's business. Corning's need for cash and its goal to reshape its operations, not the 1949 consent decree, compelled the liquidation, and the resulting income is fully apportionable.[9] The Virginia Supreme Court's contrary decision directly conflicts with the decisions of sister state courts of last resort. It creates an enormous state tax loophole by allowing corporations to use *ASARCO* as a sword to exempt income from intangibles from apportionment. Virginia and its amici urge this Court to grant a writ of certiorari to clarify the scope of *ASARCO* and provide authoritative guidance as to the standards applicable to apportioning income from intangibles.

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[9] As the Virginia Supreme Court's opinion acknowledges (Pet. App. 3), Corning *requested* that the consent decree be modified to require divestiture of 90% of its stock by 1986. Corning requested the modification because among other things, "an amendment to the Internal Revenue Code enacted since entry of the final judgment constitutes a significant change in circumstances warranting such modification." Motion for Modification of Final Judgment dated Sept. 8, 1978 (II Va. Sup. Ct. App. 428-29).

## CONCLUSION

For the reasons stated in this Reply Brief, in Virginia's Petition and in the supporting States' Amicus Brief, Virginia's Petition for a Writ of Certiorari should be granted.

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